REVIEW OF THE RESULTS OF TWO AUDITS OF THE NATIONAL ECOLOGICAL OBSERVATORY NETWORK

HEARING

BEFORE THE

COMMITTEE ON SCIENCE, SPACE, AND TECHNOLOGY
HOUSE OF REPRESENTATIVES

ONE HUNDRED THIRTEENTH CONGRESS

SECOND SESSION

December 3, 2014

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REVIEW OF THE RESULTS OF TWO AUDITS OF THE NATIONAL ECOLOGICAL

NETWORK

WEDNESDAY, DECEMBER 3, 2014

HOUSE OF REPRESENTATIVES,
COMMITTEE ON SCIENCE, SPACE, AND TECHNOLOGY,
Washington, D.C.

The Committee met, pursuant to call, at 10:05 a.m., in Room 2318 of the Rayburn House Office Building, Hon. Lamar Smith [Chairman of the Committee] presiding.

LAMAR S. SMITH, Texas
CHAIRMAN

EDDIE BERNICE JOHNSON, Texas
RANKING MEMBER

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House of Representatives
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Review of the Results of Two Audits of the National Ecological Observatory Network (NEON)

Wednesday, December 3, 2014
10:00 a.m. to 12:00 p.m.
2318 Rayburn House Office Building

Witnesses

Hon. Allison Lerner, Inspector General, National Science Foundation

Hon. Anita Bales, Director, Defense Contract Audit Agency

U.S.HOUSE OF REPRESENTATIVES
COMMITTEE ON SCIENCE, SPACE, AND TECHNOLOGY

HEARING CHARTER

Results of Two Audits of the National Ecological Observatory Network

Wednesday, December 3, 2014
10:00 a.m. – 12:00 p.m.
2318 Rayburn House Office Building

Purpose

On Wednesday, December 3, 2014, the Committee on Science, Space, and Technology will hold a hearing to review the findings of two financial audits of the National Ecological Observatory Network (NEON) project conducted by the National Science Foundation (NSF) Office of Inspector General (OIG) and Defense Contract Audit Agency (DCAA). NEON is the name of the project, and NEON Incorporated is the independent 501(c)(3) corporation created to build, operate, and manage the network.

The auditors of NEON's cost proposal issued an adverse opinion in September 2012, stating that the proposal did not form an acceptable basis for NSF's negotiation of a fair and reasonable price. NSF disagreed with this recommendation and proceeded with the $433.7 million construction award to NEON, Incorporated. The second audit of NEON's accounting system was then conducted by the NSF OIG and DCAA. This audit included NSF's approval of management fees for non-profit corporations like NEON, Inc. DCAA auditors found that NEON used the management fee to pay for such items as $112,000 lobbying contracts, $25,000 for a holiday party, and $11,000/year for coffee services. The NSF OIG investigated this information and referred two fraud cases to the U.S. Department of Justice.

NEON is a continental-scale ecological observation facility with 62 planned sites across the United States sponsored by the National Science Foundation to gather and synthesize data on the impacts of climate change, land use change and invasive species on natural resources and biodiversity over 30 years.[1] NEON is the largest National Science Foundation Major Research Equipment and Facilities Construction (MREFC) project in its FY2015 budget request of $96 million.[2]

Witnesses

- **The Honorable Allison Lerner**, Inspector General, National Science Foundation
- **Ms. Anita Bales**, Director, Defense Contract Audit Agency (DCAA)

[1] http://www.neoninc.org/about
[2] http://www.nsf.gov/about/budget/fy2015/pdf/01_fy2015.pdf

Chairman SMITH. The Committee on Science, Space, and Technology will come to order. Good morning to everyone here, and I appreciate the Member attendance we have this morning as well.

Welcome to today's hearing entitled the "Review of the Results of Two Audits of the National Ecological Observatory Network." I recognize myself for five minutes for an opening statement and then the Ranking Member.

Today's hearing will focus on one of the National Science Foundation's most ambitious major research facility projects, the National Ecological Observatory Network, or NEON.

We are fortunate to have with us the heads of two government organizations that are responsible for assuring that taxpayers get their money's worth from the Federal contracts with private entities like NEON. Our witnesses will discuss two audits of the NEON project conducted by the Defense Contract Audit Agency under contract with the National Science Foundation Office of the Inspector General.

The NSF entered into a long-term agreement with NEON to develop and operate the project's network of more than 100 fixed and mobile sensors. This audit identified more than $150 million in unsupported or questionable costs in the NEON proposal. It concluded that there was not a "fair and reasonable basis" for NSF to enter into the contract. Nevertheless, NSF did not wait for the audit results. It instead finalized an agreement based on NEON's original cost proposal.

Audits have raised questions about cost proposals that were accepted by NSF for several major projects. These includ the Ocean Observatories Initiative, the Advanced Technology Solar Telescope, NEON, and currently the Large Synoptic Survey Telescope.

In response to these audits, NSF has made a number of adjustments to how the agency evaluates costs of major projects. The $150 million in unsupported and questionable costs in the NEON proposal demonstrates that major problems at NSF continue.

Auditors discovered several highly questionable expenditures of taxpayer funds by NEON, including hundreds of thousands of dollars spent on lobbying, lavish parties, liquor for office happy hours, over $1,000 per month for premium coffee service, and trips to a high-end resort in France.

These suspicious taxpayer-financed activities were not detailed in the audit submitted to the NSF Inspector General, which was limited in scope. But to his credit, the principal auditor, J. Kirk McGill, invoked the Whistleblower Protection Act to make sure that the Inspector General, Congress, and ultimately the public was aware of hundreds of thousands of taxpayers' dollars being spent on improper activities.

I hope to hear from our witnesses on what basis NEON concluded, for example, that spending $25,000 for a holiday party last year was an appropriate use of Federal funds. And why did NSF allow this to happen? Our Committee may want to hear directly from the NSF and NEON about these audits at a hearing next year.

Federal agencies must be held accountable for their waste and misuse of taxpayer funds. And the NSF needs to be held accountable for how they spend taxpayers' hard-earned dollars. The basic responsibility of any government agency is to act in the national interest. The NSF needs to meet that standard.

That concludes my opening statement.

[The prepared statement of Mr. Smith follows:]

COMMITTEE ON
SCIENCE, SPACE, AND TECHNOLOGY
CHAIRMAN LAMAR SMITH

For Immediate Release
December 3, 2014

Media Contacts: Zachary Kurz
(202) 225-6371

Statement of Chairman Lamar Smith (R-Texas)

Review of the Results of Two Audits of the National Ecological Observatory Network

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Chairman SMITH. And the gentlewoman from Texas is recognized for hers, Eddie Bernice Johnson.

Ms. JOHNSON. Thank you very much, Mr. Chairman.

I have to confess that I am baffled by today's full Committee hearing. There may be legitimate policy and management issues for this committee to consider, but this particular hearing at this time is in my opinion premature, incomplete, and lacks balance. Therefore, it is impossible to have a full discussion on any of the legitimate oversight issues that we could examine.

As I am sure you are aware, Inspector General Lerner and NSF's Director Dr. Cordova have initiated reviews of NSF's policies and oversight of management fees and those reviews are not yet complete. NSF is also investigating spending specific to NEON and that is also underway.

Today, the most we will hear is some preliminary observations from IG Lerner and Ms. Bales that NSF should consider tightening up its policies with respect to management fees. Perhaps the agency should do just that but the October 2014 DCAA audit report being reviewed today was not made available to NSF until two weeks ago and it made no mention of management fees. So while the discussion was had at the staff level about inviting NSF, there was agreement that it was too late to reasonably expect the agency to prepare testimony for this hearing and at the same time premature for the reasons I have already described. If we had postponed this hearing until next year, as my staff urged your staff to do, we might have included NSF on this panel to present their own findings and plans with respect to the management fees.

We will also hear testimony from the witnesses about contingency fees. NSF senior management and IG Lerner have been at an impasse on the use and management of contingency fees for construction projects for four years. Both had the opportunity to share their views before this committee at a 2012 hearing. Since that time, OMB has updated its own guidance on contingencies. As my staff understands the update of regulations, some of the specific areas of dispute, such as how contingency expenditures are tracked, should now be settled.

There are other areas of dispute such as how the contingency fund is managed that remain open to debate among reasonable people. That is a key point. For these particular policy issues there is no clear right or wrong so how do we expect to have any meaningful discussion about these disputes today without the agency at the table to represent—to present and defend its own positions?

Mr. Chairman, I ask unanimous consent to submit for the record a 2013 memo from NSF's Chief Financial Officer that provides detailed justifications for the agency's current policies. However, a document for the record does not make this a balanced, complete hearing.

Chairman SMITH. Okay. Without objection.

[The information appears in Appendix II]

Chairman SMITH. And at the same time I would like to ask unanimous consent to put in the record the following documents that are in a binder I have here. And the title of the documents is "The Results of——

Ms. JOHNSON. I would like to reclaim my time now.

Chairman SMITH. —"Results of the Two Audits of the National Ecological Observatory Network." And without objection, both your request for documents in the record and mind will be so ordered.

[The information appears in Appendix II]

Ms. JOHNSON. Thank you, Mr. Chairman.

And finally, it is with some reluctance that I offer the following observations. DCAA, the Defense Contract Audit Agency, was established to audit DOD contracts subject to defense acquisition regulation. I am concerned that they simply do not have sufficient staff with expertise or experience to appropriately audit NSF's grants and cooperative agreements.

My staff has heard from several entities audited by DCAA on behalf of the IG that the auditors repeatedly asked for the wrong documentation and made significant errors in their assessment of information. Further, auditors repeatedly failed to work with the audited entity in a transparent way that would have resolved significant costs that were later questioned in publicly available documents, including the IG's semiannual reports. Having heard common complaints from several unrelated entities, I am unwilling to attach too much weight to any adverse findings by DCAA without further review.

Unfortunately, problems with DCAA's audit have caused significant and ongoing tension between the IG and NSF management for several years and have put credible NSF awardees unnecessarily at risk. These problems also color today's hearing.

Ms. Bales, please do not take my comments as a personal criticism; I am just concerned that the auditing organization's skills fit the job when we are rendering judgments about the proper use of Federal funds and questioning the performance of world-class research institutions and organizations. We didn't even see DCAA testimony for this hearing until 5:00 last night.

Mr. Chairman, I want to join you in conducting legitimate oversight of the National Science Foundation, but for the reasons that I have mentioned, I don't think we will—this will be possible for today's hearing.

Thank you and I yield back.

[The prepared statement of Ms. Johnson follows:]

OPENING STATEMENT

Ranking Member Eddie Bernice Johnson (D-TX)
Committee on Science, Space, and Technology

"Review of the Results of Two Audits of the National Ecological Observatory Network"
Full Committee Hearing

December 3, 2014

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I am concerned that they simply do not have sufficient staff with the expertise or experience to appropriately audit NSF's grants and cooperative agreements. My staff has heard from several entities audited by DCAA on behalf of the IG that the auditors repeatedly asked for the wrong documentation and made significant errors in their assessment of information. Further, auditors repeatedly failed to work with the audited entity in a transparent way that would have resolved significant costs that were later questioned in publicly available documents, including in the IG's semi-annual reports. Having heard common complaints from several unrelated entities, I am unwilling to attach too much weight to any adverse findings by DCAA without further review.

Unfortunately, problems with DCAA's audits have caused significant and ongoing tension between the IG and NSF management for several years, and have put credible NSF awardees unnecessarily at risk. These problems also color today's hearing.

Ms. Bales, please do not take my comments as a personal criticism. I am just concerned that the auditing organization's skills fit the job when we are rendering judgments about the proper use of federal funds and questioning the performance of world-class research institutions and organizations.

Mr. Chairman, I want to join you in conducting legitimate oversight of the National Science Foundation. But for the reasons I have mentioned, I don't think that will be possible at today's hearing.

With that I yield back.

Chairman SMITH. Thank you, Ms. Johnson.

And I will introduce our witnesses today but I will say preliminarily that I appreciate all the good work you all have done. I appreciate the fact that you are individuals of integrity and have contributed much to help us conduct our legitimate oversight responsibilities.

Our first witness, Ms. Allison Lerner, is the Inspector General for the National Science Foundation and the Chair of the Council of the Inspectors General on Integrity and Efficiency. Ms. Lerner previously served in leadership positions at the Department of Commerce and was selected by the President to be a member of the Government Accountability Transparency Board in 2011. Ms. Lerner received her bachelor's and her law degree from the University of Texas. She is certainly no stranger to the Committee and we are happy to welcome her back to the witness table.

Our second witness, Ms. Anita Bales, is the Director of the Defense Contract Audit Agency. The NSF Office of the Inspector General relies on the DCAA to perform audits of National Science Foundation major research facilities like NEON, which the Inspector General reviews and submits to the National Science Foundation. Before her work at DCAA, Ms. Bales served as the Deputy Auditor General for Forces and Financial Audits of the Army Audit Agency. Ms. Bales received her bachelor's degree in business administration from Drake University and her MBA from Syracuse University. She is the recipient of the President's Council on Integrity and Efficiency Award for Auditing, and we are happy to have you with us today as well.

And, Ms. Lerner, would you begin?

TESTIMONY OF THE HONORABLE ALLISON LERNER, INSPECTOR GENERAL, NATIONAL SCIENCE FOUNDATION

Ms. LERNER. Thank you. Mr. Chairman and Members of the Committee, I appreciate this opportunity to discuss two audits of the National Ecological Observatory Network and my office's efforts to help ensure that NSF spends taxpayer dollars effectively and for the intended purpose of advancing scientific research.

We contracted with DCAA in 2011 to perform an audit of NEON's $433 million proposed budget to determine if it was prepared in accordance with federal requirements and formed an acceptable basis for the negotiation of a fair and reasonable price. From July through September 2011 DCAA issued three inadequacy memoranda stating that NEON's proposed budget could not be audited. The final such report found that none of the proposed cost elements for labor, overhead, equipment, and other items reconciled to supporting data. DCAA also found the proposal included more than $74 million in unallowable contingency costs and more than $1 million in unallowable honoraria.

In February 2012 NEON submitted a revised budget proposal which DCAA was able to audit. Despite working with NEON for several months to clear inadequacies in the proposal, auditors found a total of $154 million, or nearly 36 percent of the total budget, in questioned and unsupported costs. The entire $72.6 million proposed contingency was questioned. In addition, more than 13 of the $14 million in costs for materials and nearly $16 million of equipment costs could not be supported. Other questioned costs included $1.8 million in management fees for unallowable costs.

As a result, in September 2012 auditors issued an adverse opinion stating that the proposal did not form an acceptable basis for the negotiation of a fair and reasonable price. Among other things, we recommended that NSF require NEON to submit a revised budget with support for all proposed costs. NSF disagreed with this recommendation and also stated that it had provided management fee and awards for the construction or operation of large facilities for years.

In light of the problems with the NEON budget, we commissioned DCAA to audit NEON's accounting system. As the audit was proceeding, DCAA informed us that management fee had been awarded and used for unallowable costs, including $112,000 for lobbying and $25,000 for a holiday party. We investigated the allegations and referred them to the Department of Justice, which declined to accept the case for further investigation or prosecution. We have added a review of the awarded use of management fees to our Fiscal Year 2015 audit work plan.

It is essential for cost information for proposed budgets to be accurate, current, and adequately supported because the budget is the basis for charging costs in NSF. The problems we found with the budgets were not limited to the NEON project. In fact, we found that NSF approved proposed budgets for four major projects totaling more than $1.4 billion although significant questions existed as to the adequacy of those budgets. As a result, while NSF knows what it will spend on these projects, it is not clear whether it knows what they should cost.

As we work to resolve recommendations made on audits of proposed costs for NSF's large facility projects, we identified broader weaknesses in NSF's pre- and post-work monitoring processes for high-dollar, high-risk projects and compounded our concern that unallowable costs could be charged to awards. We recommended that, at a minimum, NSF increase monitoring for its largest cooperative agreements valued at $50 million or more. In our judgment, the actions NSF has proposed to take to address OIG recommendations in this area fall short of the standard necessary to adequately safeguard federal funds and leave millions of dollars at risk.

As a result, in May we escalated the unresolved recommendations. We took this step in light of the serious risk to federal funds posed by NSF's current processes and practices. NSF did not sustain our recommendation to require awardees to remove contingency from proposed budgets. We are awaiting NSF's decision on the remaining recommendations.

We target our work to areas that pose the highest risk of misuse of taxpayer dollars and can lead to funds used inappropriately being returned to the government. To that end, our Fiscal Year 2015 audit work plan includes incurred cost audits and accounting system audits of more than 10 awardees, as well as the focus on the use of management fees. Incurred cost audits are critical to proper monitoring and can reveal costs claimed that are unallowable or unreasonable.

We have been urging NSF for the past four years to strengthen accountability over its high-dollar, high-risk agreements for large facility construction projects. NSF applies its highest level of attention and scrutiny to determine the scientific merit of the projects it decides to fund. It is imperative that it applies the same rigorous attention and scrutiny to its financial management of these projects. The stakes are too high for the foundation to continue its current practice of making awards before it ensures that project costs are reasonable, are supported by adequate documentation, and will use taxpayer dollars efficiently. And I would be happy to answer any questions.

[The prepared statement of Ms. Lerner follows:]

Statement of Allison C. Lerner

Inspector General

National Science Foundation

Before a Hearing of the

Committee on Science, Space, and Technology

United States House of Representatives

Mr. Chairman and Members of the Committee, I appreciate this opportunity to discuss two audits of the National Ecological Observatories Network (NEON). As requested, I will also address my office's continuing efforts to help ensure that the National Science Foundation (NSF) spends taxpayer dollars effectively and for the intended purpose of advancing scientific research.

As background, NEON is a non-profit organization, funded by NSF in 2011 under a Cooperative Support Agreement to build and operate a continent-wide network of ecological observatories. We initially contracted with the Defense Contract Audit Agency (DCAA) in 2011 to perform an audit of NEON's proposed budget. The following year, we retained DCAA to audit NEON's accounting system. For reference, OIG has often utilized DCAA for audit support given that agency's expertise and our own in-house staff shortages. DCAA conducts these audits independently and provides its conclusions to OIG. Staff members in OIG serve as contract monitors, ensuring that the quality of the work is sound and that the audit is completed as agreed.

I will discuss these audits, as well as related systemic issues, including NSF's overall management and oversight of its high-dollar, high-risk cooperative agreements.

Audit of NEON's Cost Proposal

In 2011, we contracted with DCAA to audit NEON's $433.7 million proposed budget for the construction of the National Ecological Observatories Network, which will take place over a five-year period from August 1, 2011 through July 30, 2016. The objective of that audit was to examine the NEON construction proposal to determine if the proposed budget was prepared in accordance with applicable federal requirements and formed an acceptable basis for negotiation of a fair and reasonable price.

The audit was started in June 2011, and DCAA, the OIG, and NSF management met several times over the next four months to discuss issues that arose during DCCA's attempt to obtain information from NEON. In July 2011, DCAA issued its first of three inadequacy memoranda stating that NEON's $433.7 million proposed budget could not be audited because the proposed budget amounts lacked supporting cost and pricing data. Between July and September 2011, DCAA conducted a number of walkthroughs of the proposal with NEON as it attempted to assess the support and basis for the estimated costs in the proposed budget. During this time, OIG also met several times with DCAA.

Despite these efforts, NEON was unable to provide adequate support for the cost proposal and in August 2011, DCAA issued a second inadequacy memo. In September 2011, a third audit attempt again found NEON's cost proposal to be inadequate for audit. DCAA reached this conclusion because none of the proposed cost elements for labor, overhead, equipment, and other items reconciled to supporting data. Further, the proposal included more than $74 million in contingency costs, which DCAA found were unallowable under federal requirements, and more than $1 million in unallowable honoraria costs.

In addition, NSF issued the results of its Business System Review for NEON in November 2011. NSF conducts these reviews for large facilities in construction or operation to assess the business practices of awardee institutions. The review for NEON identified "a number of high risk issues" across the eight areas examined, which included financial management, procurement, and property and equipment. We are not certain what actions NSF has taken to ensure that NEON addressed the issues raised in the Business System Review.

On February 17, 2012, NEON submitted a revised budget proposal, which DCAA attempted to audit. Despite working with NEON for several months to proceed with the audit and to clear inadequacies in the proposal, auditors found a total of $154.4 million (nearly 36 percent of the proposed $433.7 million budget) in questioned and unsupported costs. Questioned costs totaled $102.1 and unsupported costs totaled $52.3 million.

The entire $72.6 million of proposed contingency, which DCAA found was unallowable under OMB cost principles, was questioned. It is important to note that even if contingency amounts in the proposed budgets met the definition in OMB guidance, as NSF asserts, there is a second, serious problem with respect to the adequacy of the supporting documentation for the contingency. Beyond contingency, NEON could not provide support for more than $13 million of the $14 million in costs for materials or for nearly $16 million in equipment costs. The questioned costs also included $1.87 million in proposed management fees for unallowable costs.

As a result, auditors issued an adverse opinion in September 2012, stating that the proposal did not form an acceptable basis for the negotiation of a fair and reasonable price. We issued the audit to NSF on September 28, 2012, and recommended that it require NEON to submit a revised budget with adequate supporting documentation for all proposed costs. We also recommended that NSF require NEON to remove unallowable contingency provisions from its proposed budget and discontinue funding contingencies until an awardee could demonstrate a bona fide need for the funds supported by adequate supporting documentation.

In April 2014, NSF informed us that it disagreed with the OIG's recommendations and asserted that NEON had supplied supporting documentation for the proposed costs following the audit. NSF also stated that for years its practice had been to provide a management fee under awards for construction of operation of large facilities.

Audit of NEON's Accounting System

Although auditors had concluded that nearly 36 percent of the costs in its proposed budget were either questioned or unsupported, NSF proceeded with the $433.7 million construction award to NEON, and thus, we commissioned DCAA to audit NEON's accounting system. The purpose of the audit was to determine if the accounting system complied with the grant terms.

As the audit was proceeding, DCAA auditors informed us that management fee had been awarded and used for unallowable costs, including $112,000 for lobbying contracts, $25,000 for a holiday party, $11,000 for coffee services, and $3,000 for Board of Directors dinners (that included alcohol). This formed the basis for two fraud referrals from the auditor to NSF OIG. In response, we investigated the allegations and referred the matter to the United States Department of Justice for possible further investigation and/or prosecution. The Department of Justice declined to accept the case. We have added a review of the award and use of management fees to our FY 2015 audit work plan.

As OIG monitors communicated with DCAA during this audit as part of our oversight responsibility, we learned that an initial draft from the DCAA field office conducting the work cited eight conditions constituting non-compliance with federal and/or NSF requirements. The use of management fee for unallowable costs, such as parties and lobbying was one area raised by the DCAA field office. However, DCAA's final report, provided to OIG on October 3, 2014, included only one finding, which related to NEON's timekeeping practices. The final report did not cite management fee or any of the other areas (aside from timekeeping) raised by the field office. DCAA informed us that it had followed its established process for resolving differences of opinion between members of the audit team.

Throughout the course of this audit, and especially after we learned of the draft containing eight issues, our oversight monitors repeatedly sought information and clarification from DCAA. For example, in March 2014 we met with representatives from DCAA regional and headquarters offices; in early April, following that meeting we asked DCAA to respond to a number of questions including how NEON classified management fee in its budget, whether NEON was required to track use of management fee, what internal controls existed to monitor NEON's use of management fee, and whether management fee was being reported in NEON's accounting system. We followed up on these questions several times and asked additional questions; DCAA responded to us in June.

Also, in April we asked DCAA to give us a separate document to explain two of the most significant issues raised in the draft—contingency expenditures and management fees. In October 2014, DCAA provided a letter of observations, which elaborated on these matters. As to management fees, the letter explained that NSF policy makes it clear that such fee "is permissible if approved by the grants/management officer" and that it was approved for NEON. DCAA further stated that NSF had initially awarded management fees to NEON on a reimbursable basis, and the awardee used the fees to cover unallowable cost that it had already incurred. Subsequent awards involved an upfront management fee with a not-to-exceed amount for the life of the cooperative agreement. The letter noted that DCAA was not able to find any NSF policy concerning when a fee should be awarded or limits on how it is to be used by awardees.

With respect to contingency expenditures, DCAA recommended that NSF require awardees to separately track, in more than detail than they are currently doing, the use of proposed contingency costs in the budget control log as a condition of the award, and that they provide fully supported bases of estimates for contingencies.

Problems with Budgets Extend Beyond NEON

In addition to the work on NEON, for the past four years we have directed significant attention to proposed construction budgets for three of NSF's other high-risk, high-dollar cooperative agreements for large construction projects. It is essential for cost information for proposed budgets to be accurate, current, and adequately supported because the budget is basis for charging costs to NSF. We found that NSF approved proposed budgets for four major projects, totaling more than $1.4 billion (including NEON), although significant questions existed as to the adequacy of the proposed budgets. As a result, while NSF knows what it will spend on these projects, it is not clear whether it knows what they should cost.

For example, starting in 2010 attempts to audit the $386.4 million proposed budget for the Ocean Observatories Initiative found $88 million of questioned contingency costs that could not be supported adequately after 17 months of audit work. Repeated attempts to establish a sound basis for the $344.1 million proposed budget for construction of the Advanced Technology Solar Telescope (now referred to as DKIST), resulted in a disclaimer of audit opinion in September 2014 after a re-baselined cost proposal was presented in 2012. (The previous proposal had been twice found unacceptable for audit in 2010 due to lack of support for labor and indirect costs and unsupported estimates and outdated vendor quotes.)

In light of the serious concerns raised by this work and our recommendations to NSF that it strengthen accountability over the millions of dollars invested in its high-risk construction projects, we watched closely to see what NSF would do to ensure the adequacy of the $467.7 proposed cost for the Large Synoptic Survey Telescope, the first construction project the Foundation considered since our recommendations. NSF's own internal review for the project's costs could not find support for *any* of the 136 transactions it sampled, which included labor charges, fringe benefits, and contingencies. However, NSF is proceeding with this project.

Wider Problems with Cooperative Agreements for Large Facility Construction

As we worked to resolve recommendations in audits of proposed costs for NSF's large facility projects, we identified weaknesses in NSF's pre- and post-award monitoring processes for high-risk projects that compounded our concern that unallowable costs could be charged to awards. At the pre-award stage, NSF does not require a proposal or accounting system audit for high-risk, high-dollar cooperative agreements prior to award. Without such audits, NSF is left making funding decisions without adequate information to confirm the reasonableness of the cost estimates.

At the post-award stage, NSF does not routinely obtain incurred cost submissions or audits to determine if costs claimed by awardees are allowable. While not required by law or regulation, such submissions and audits are essential tools for ensuring accountability in high-risk, high-dollar projects. In their absence, unallowable costs charged to these awards may go undetected because NSF lacks sufficient visibility over incurred costs.

We raised these systemic concerns in an Alert Memorandum to NSF on September 28, 2012 and recommended that NSF, using a risk-based approach, develop end-to-end cost surveillance policies and procedures for its cooperative agreements to ensure stewardship over federal funds. At a minimum, we recommended that NSF increase monitoring for its largest cooperative agreements valued at $50 million. At the pre-award stage, this would include obtaining updated cost estimates and audits of awardees' proposed budgets and cost accounting systems/estimating practices. At the post-award stage, we recommended that monitoring include requiring annual incurred cost submissions and incurred cost audits.

In response, NSF asserted that its existing practices were sufficient to ensure adequate oversight for such cooperative agreements and disagreed with our recommendations to strengthen accountability.

Status of NSF Action on OIG Recommendations

During the past four years OIG and NSF staff have met on multiple occasions to discuss the OIG's recommendations stemming from a large body of audit effort and NSF's proposed actions to strengthen accountability over its high-dollar, high-risk, cooperative agreements for large facility construction projects. Despite this effort, the actions NSF has proposed to take to address OIG recommendations fall short of the standard necessary to adequately safeguard federal funds and leave millions of dollars at risk.

Therefore, following the audit resolution process under OMB Circular A-50, on May 22, 2014, OIG escalated the unresolved recommendations from this work -- including recommendations in the NEON proposal audit, and the Alert Memorandum -- to the Audit Follow-up Official, NSF's then-Deputy Director. Escalation of OIG recommendations is the final step available to the OIG in an attempt to urge NSF to strengthen accountability and to exercise proper stewardship of federal funds. We took this step in light of the serious risk to federal funds posed by NSF's current processes and practices.

Because the same or very similar recommendations were made in multiple reports, we grouped them together into the following five categories:

- Obtain updated cost estimates and audits of awardee's proposed budget and cost accounting/systems/practices prior to awards for cooperative agreements valued at over $50 million.

- Require annual incurred cost submissions and incurred costs audits for cooperative agreements in excess of $50 million.
- Using a risk-based approach, develop end-to-end cost surveillance policies and procedures for its cooperative agreements to ensure adequate stewardship over federal funds. At a minimum, NSF should implement such increased monitoring for its largest cooperative agreements valued at more than $50 million.
- Remove unallowable contingency from proposed budgets and ensure that internal contingency policies and procedures reflect OMB cost principles.
- Require awardees to properly account for contingency funds consistent with their estimates and separately track budgeted versus actual contingency costs; and retain control over funds budgeted for unforeseeable event and release funds only when the awardee demonstrates a bona fide need supported by verifiable data.

On August 8, 2014, the then-Deputy Director decided not to accept any of OIG's recommendations. Following the Deputy Director's retirement, the Acting Chief Operating Officer, as the new Audit Follow-up Official, informed OIG that he would review that decision. On October 16, 2014, the Acting Chief Operating Officer rejected the OIG's recommendation for NSF to require awardees to remove unallowable contingency from their proposed budgets and to ensure that NSF's contingency policies and procedures reflect OMB cost principles. We are awaiting his decisions on the remaining recommendations.

OIG's Sustained Commitment to Ensure Effective Use of Taxpayer Dollars by NSF

We target our work and direct our resources to areas that pose the highest risk of misuse of taxpayer dollars and can lead to funds used inappropriately being returned to the government. To that end, our FY 2015 audit work plan includes incurred cost audits and accounting system audits of more than ten NSF awardees, as well as a focus on the use of management fees. Incurred cost audits are critical to proper monitoring and can reveal instances of noncompliance with federal regulations as well as costs claimed that are unallowable or unreasonable. The audits will provide vital information and also prevent recurrence of any infractions in future periods of the awards. NSF does not routinely require such audits for its high-dollar, high-risk cooperative agreements.

My office also conducts mandatory audit work in fulfilling our mission to detect and prevent waste, fraud, and abuse of taxpayer dollars. This work includes the annual audit of NSF's financial statements and our review of NSF's compliance with the Improper Payments Elimination and Recovery Improvement Act. We also review the results of Single Audits, required of NSF awardees that receive $500,000 or more in federal funds annually, to identify risk areas that warrant follow up by our office.

Another area we are closely monitoring is NSF's planned relocation of its new headquarters.

Our ongoing inspection of NSF's relocation to its new headquarters in Alexandria, VA has identified concerns about missed schedule milestone dates that have occurred, and could continue to occur, as a result of the ongoing impasse between NSF and its union with respect to issues related to NSF's new headquarters, and the possible financial impact of the schedule slippage.

As detailed in our recent alert memo, any delays caused by NSF (rather than by the builder) to the December 2016 completion date could require NSF to pay delay costs in addition to rent costs at NSF's current headquarters. Due to the building schedule's milestone dates that NSF has already missed, the potential cost of any delays, and the potential for protracted negotiations with the union, we have recommended that NSF senior management focus the highest level of attention on this issue. We will continue to closely monitor NSF's move to its new building to inform Congress and NSF.

Our investigations are also directed at helping to ensure that taxpayer dollars are used as intended to advance NSF's mission of scientific research. To this end, we have focused attention on fraud in the Small Business Innovation Research Program (SBIR) and the Small Business Technology Transfer (STTR) program. A primary purpose of these programs is to use small business to meet federal research and development needs, and my office has aggressively pursued companies and individuals who have attempted to fraudulently divert these important funds to their own use. For example, in one recent case a university professor was convicted on seven felony counts including wire fraud, mail fraud, falsification of records, and theft. Among other things, this individual created fraudulent company time sheets, which he backdated and falsely represented as timekeeping records, and created a fraudulent expenditure ledger in which he recorded fictitious expenses to conceal that he spent the STTR funds on his home mortgage and personal credit cards.

In another case, a jury found a company CEO guilty of seven counts including making false statements and claims, and wire fraud. The CEO used approximately $60,000 in STTR funds to pay off his personal credit card debt. It is unconscionable that unscrupulous individuals seek to use scarce research dollars to enrich themselves and we will continue to work to bring such individuals to justice.

Review of NSF Management Fee Awards

In response to issues that have surfaced about management fees, and as mentioned, we included a review of management fee in NSF awards in our Fiscal Year 2015 audit plan. As an initial step to inform our understanding of management fees, OIG staff researched the subject and developed a white paper, which addresses the historical context giving rise to use of such fees, as well as internal and external guidance or authority pertaining to management fees. The paper also provides some initial observations about NSF management fee awards. The second stage of this audit, which will focus on NSF's process and controls over awarding and managing management fees, should begin in early 2015.

Historical backdrop and concerns

Our look at this area found that management fees have long been provided to Federally Funded Research and Development Centers (FFRDCs) based on a recognition that these centers -- which are typically non-profit entities almost wholly dependent on government funding -- might need to incur costs that could not be reimbursed by the government. The fee was designed as a mechanism or tool to ensure that an FFRDC's "ordinary and necessary" but otherwise nonreimbursable business expenses would be covered to maintain the entity's financial viability. Such expenses might include working capital and interest payments.

Through a series of reports, beginning in the 1980s, GAO identified a number of issues relating to management fees. For instance, in a 1982 report it described concerns about the term "fee," which GAO explained is normally associated with the for-profit rather than the non-profit world. According to GAO, "[f]ees paid to for-profit organizations are viewed as contributions to profits, whereas fees paid to nonprofit organizations are considered necessary to provide required operating capital and to cover certain nonreimbursable expenses." The report noted that as early as 1969, GAO recommended that the Office of Management and Budget adopt governmentwide guidelines clearly limiting management fees to the amount needed to enable organizations to accumulate a reserve to provide for operational stability and to pay prudent business expenses not otherwise reimbursable. The need for concrete guidelines to prevent fees from being used inappropriately was reiterated in two reports that GAO issued in 1995 and again in 1996 and 2008.

NSF policy and practice

NSF's grant policy documents allow for management fees if they are contemplated in the proposal solicitation and in certain instances when they are not. Management fees are to be negotiated, after consideration of a number of specified factors, and may not exceed fifteen percent of the total project costs provided by NSF (excluding the fee).

In correspondence to Senators Charles Grassley and Rand Paul dated October 1, 2014, NSF elaborated that it considers several points in deciding whether a fee is warranted in the first instance. These include "addressing unreimbursed costs deemed ordinary and necessary for operations," as well as "attract[ing] qualified organizations," and "utili[zing] . . . fee as a performance incentive." The Foundation also stated that it views the fees as discretionary funds, and does not require awardees to report on their management fee expenditures.

Use of Management Fees by Other Federal Agencies

Although we have not conducted formal benchmarking, our background research found that the Department of Defense has an FFRDC management plan, which permits management fee awards for ordinary and necessary business expenses necessary to "maintain a healthy company." The plan contemplates an annual review of these fees, which involves examining whether actual uses were consistent with prior representations and justifications. We also found that the National Aeronautics and Space Administration is promulgating a rule that prohibits that agency from awarding profit and fee under grants and cooperative agreements. In its Federal Register notice, NASA has explained that this includes management fee. We were unable to find any explicit government-wide guidance or authority concerning management fees that sheds further light on this subject.

Initial observations about NSF management fee awards

Although our review is now entering its second phase, which will involve a deeper look at how NSF has awarded the fees and how they were used, we are able to make some initial observations which will warrant further scrutiny as the review proceeds. NSF management fee recipients have other sources of income besides NSF awards:

- Some of the factors that NSF appears to consider in determining whether to award a management fee (such as fee to attract organizations and to provide a performance incentive) appear to be inconsistent with the historical purpose of such fees, which is to cover ordinary and necessary business expenses to maintain an entity's financial viability.
- NSF's view that management fees represent discretionary funds is also at odds with this historical purpose.
- At least one awardee, NEON, has used management fees for questionable expenditures.

As previously noted, an in-depth review of management fee will be undertaken as part of my office's ongoing efforts to help ensure that NSF is spending taxpayer funds effectively. This work will endeavor to fully assess the risk environment and, based on what we learn, will result in appropriate recommendations to address that risk.

Conclusion

We have been urging NSF for the past four years to strengthen accountability over its high-dollar, high-risk cooperative agreements for its large facility construction projects. NSF applies its highest level of attention and scrutiny to determine the scientific merit of the projects it decides to fund. It is imperative that NSF apply the same rigorous attention and scrutiny to its financial management of these projects, prior to requesting NSB approval for award. The stakes are too high for the Foundation to continue its current practice of requesting NSB approval and making awards before it ensures that project costs are reasonable, are supported by adequate documentation, and will use taxpayer dollars efficiently.

Our work reflects my office's sustained commitment to helping NSF be an effective steward of taxpayer dollars and, and we look forward to our continued partnership with NSF and the Congress to this end.

Allison C. Lerner, Inspector General, National Science Foundation

Allison C. Lerner assumed the duties as Inspector General of the National Science Foundation (NSF) in April 2009. As head of the Office of Inspector General she recommends policies for promoting economy, efficiency and effectiveness of NSF programs and operations. She leads efforts to prevent and detect fraud, waste, and abuse; improve the integrity of NSF programs and operations; and investigate allegations of misconduct in science. Prior to becoming Inspector General at NSF, Ms. Lerner served in leadership positions at the Department of Commerce, including Counsel to the Inspector General.

Ms. Lerner has received several national awards for excellence, and in June 2011 she was selected by the President to be a member of the Government Accountability and Transparency Board. She currently chairs the Counsel of the Inspectors General on Integrity and Efficiency Working Groups on Suspension and Debarment Research Misconduct and grant reform.

Ms. Lerner received her law degree and her undergraduate degree from the University of Texas.

Chairman SMITH. Thank you, Ms. Lerner.
Ms. Bales.

TESTIMONY OF THE HONORABLE ANITA BALES, DIRECTOR, DEFENSE CONTRACT AUDIT AGENCY

Ms. BALES. Chairman Smith, Representative Johnson, and Members of the Committee, thank you for the opportunity to appear before you today. I have submitted written testimony for the record, and this morning I want to provide you a brief overview of DCAA and its audit role with the National Science Foundation and the National Ecological Observatory Network, which I shall refer to as NEON.

DCAA performs contract audits for DOD components and other federal agencies to help ensure contractors comply with government contract regulations. Based on its audit findings, DCAA makes recommendations to contracting officers who then make final contract decisions based on their assessment of those recommendations. The National Science Foundation requested DCAA's help with NEON, a nonprofit organization required to follow the cost principles in OMB Circular A–122 for determining costs of grants, contracts, and other agreements.

DCAA performed two significant audits at NEON. First, at the request of the NSF Inspector General, in August 2011 DCAA attempted to perform a proposal evaluation of NEON's cooperative agreement for major research equipment and construction of the National Ecological Observatory Network. Despite significant coordination with NEON, DCAA was not able to perform an audit because of several inadequacies in this proposal.

About a year later, DCAA began an audit of a revised proposal. While there were still major inadequacies associated with this proposal, DCAA was able to issue an audit report in September 2012. Of the roughly $434 million proposed by NEON, DCAA questioned about $102 million and concluded that an additional $52 million was unsupported. Questioned costs are costs the auditor considers not acceptable for negotiating a reasonable contract price or not acceptable for reimbursement. Unsupported cost denotes instances where the contractor has not provided specific evidence or documentation to support assertions.

The inadequacies noted in our audit report were significant enough for us to recommend that the proposal not be considered acceptable as a basis for negotiating a fair and reasonable cooperative agreement price.

It is also important to note that our proposal review of NEON was different from our normal forward pricing reviews in two respects. First, we were asked to review the proposal more than 7 months after the cooperative agreement had been awarded and a price established. Normally, contracting officers request a proposal audit before the award so they can make use of the auditor's recommendations to negotiate a fair and reasonable price. Second, we were asked to perform for the NSF IG. Audit requests normally come from the contracting officer who was responsible for awarding the contract and has the ability to make changes in response to the recommendations.

In addition to the forward pricing proposal and also at the request of the NSF IG, we reviewed NEON's accounting system and issued our report in October 2014. Our audit disclosed a material noncompliance with NEON's timekeeping system. Specifically, NEON's actual timekeeping practices did not comply with its written policies and procedures.

Our audit also disclosed two material noncompliances with Circular A–122 that were corrected during the course of our fieldwork. First, NEON failed to comply with the requirement that organizations receiving more than $10 million in federal funding of direct cost in a Fiscal Year must break out indirect costs into two broad categories: facilities and administration. Prior to our audit, NEON had reported these indirect costs together. Second, NEON excluded unallowable costs from the general and administrative overhead base. Unallowable costs must be included in the G&A allocation base so they absorb their share of an organization's indirect expenses. Our field work verified that NEON corrected both of these conditions after we identified them. We also issued a management letter to the NSF IG that recommended potential improvements in NSF's internal controls over contract costs.

In closing, let me assure you that we are committed to providing NSF and all civilian agencies with high-quality audits that protect the interests of the American taxpayer. Moving forward, we would like to work with NSF acquisition or grants managers and the IG through the normal contracting process to provide comprehensive contract audit services for NEON and other NSF contractors.

I appreciate the opportunity to testify before you today and I will be glad to respond to questions. Thank you.

[The prepared statement of Ms. Bales follows:]

Testimony

of

Anita F. Bales
Director, Defense Contract Audit Agency

before the

House Committee on Science, Space and Technology

on

"Review the Results of Two Audits of the National Ecological Observatory Network (NEON)"

December 3, 2014

Chairman Smith, Representative Johnson, and members of the Committee, thank you for the opportunity to appear before you today. I am pleased to provide you with an overview of DCAA's contract audit mission and responsibilities. I will also discuss the role DCAA plays in performing contract audits including grants and cooperative agreements at the National Science Foundation (NSF) and more specifically the recent work we have done at National Ecological Observatory Network (NEON).

Background

DCAA is a distinct agency of the Department of Defense (DoD) that reports to the Under Secretary of Defense (Comptroller). The DCAA mission is to perform the necessary audits of contractors for DoD components responsible for the negotiation, administration, and settlement of contracts and subcontracts. DCAA's mission supports DoD's efforts to obtain maximum value for the dollars spent in defense contracting, thereby protecting the taxpayer's interest and supporting the warfighter. Our charter was intentionally developed to permit DCAA to provide these same contract audit services to other Federal agencies.

To carry out its mission, DCAA has about 5,100 employees at 125 field audit offices around the world. More than 85 percent of DCAA's personnel are auditors. In FY 2014, DCAA performed about 6,000 audits covering $183 billion in proposed or claimed contractor costs. These reviews recommended reductions in proposed or billed costs of $10.7 billion (referred to as questioned costs), and $6.0 billion in estimated costs for which the contractor did not provide sufficient information to explain the basis of the proposed amounts (referred to as unsupported costs). In any one year, DCAA audits between 5,000 and 7,000 different contractors.

DCAA Contract Audit Effort

To support the Secretary of Defense's initiatives to get the best value for the dollars spent in defense contracting, DCAA plays a critical role in the oversight and management of government contracts by ensuring that contractors comply with government contract regulations. Based on its audit findings, DCAA makes recommendations to contracting officers in the procurement and contract management organizations. Contracting officers, in turn, make final contract decisions based on their assessment of those recommendations. While each organization plays a different role, we all work closely together throughout the contracting process.

The type and extent of DCAA audit work varies based on the type of contracts awarded; however, the majority of DCAA effort can be categorized into two groups:

Forward Pricing Reviews – DCAA performs audits of contractors' bid proposals when cost data is provided and contracting officials determine the need for audit services. In accordance with the Federal Acquisition Regulation (FAR) for both fixed-price and cost-reimbursable contracts, DCAA performs these audits prior to contract award to assist the contracting officer in negotiating a fair and reasonable price. DCAA audit services are generally limited to those procurements under FAR Part 15 (Contracting by Negotiation). During FY 2014, DCAA conducted 1,089 audits of contractor proposals covering $61.5 billion and reported cost questioned of about $7.1 billion.

Incurred Cost Reviews – DCAA performs reviews of contractors' annual incurred cost submissions. DCAA performs these audits to ensure that the costs claimed by the contractor are reasonable, allocable, and allowable. These audits also establish final indirect rates for the contractor. During FY 2014, DCAA completed more than 11,000 contractor years and reported cost questioned of about $2.7 billion.

DCAA National Science Foundation Effort

DCAA has performed contract audits for civilian agencies since its inception in 1965, a function that represents between 9 to 11 percent of our budget, or $50 to $64 million in funding. Both the type and scope of DCAA's efforts at civilian agencies are very similar to the audits we perform for the Department of Defense. Importantly, unlike the role of an Inspector General, DCAA's work for both DoD and civilian agencies focuses only on contractors and their financial assertions; DCAA does not review the actions of Government acquisition personnel, but rather acts as advisors to those personnel based on our audit findings.

The National Science Foundation, one of the civilian agencies DCAA assists, through either their IG or their Acquisition Division has asked us to perform multiple types of audit efforts to include forward pricing proposals and incurred costs. Over the last 5 years, total DCAA effort dedicated to NSF has averaged a little over 6,000 hours or almost 4 staff years' worth of effort each year.

One of the contractors that NSF requested help with is the National Ecological Observatory Network (NEON). NEON is a non-profit organization and as a non-profit must follow the cost principles outlined in OMB Circular A-122 for determining costs of grants, contracts and other agreements. While not as comprehensive OMB Circular A-122 is similar in principle and function to the Federal Acquisition Regulations (FAR). DCAA has performed two significant audits at NEON.

Forward Pricing Examinations – At the request of the NSF Inspector General in August of 2011 DCAA attempted to perform a proposal evaluation of NEON's cooperative agreement for major research equipment and construction of the National Ecological Observatory Network. Despite significant coordination with NEON, DCAA was not able to perform an audit because of numerous inadequacies in the proposal. Specifically, DCAA noted the following inadequacies in NEON's proposal:

- The proposed cost elements did not reconcile to its supporting data.
- The proposal did not include a time phasing of costs for the proposed contract period of performance.
- The proposal did not include a consolidated bill of materials and equipment for the proposed direct material and direct equipment costs under the anticipated contract.
- The proposed direct labor did not include a consolidated listing of labor costs by job categories for the contract base period which includes total direct labor costs.
- The proposal did not show how the proposed indirect costs were computed. OMB Circular A-122 requires the breakout of indirect cost components into two broad categories, *Facilities and Administration.*

These deficiencies made it impossible for the Agency to complete an audit of the proposal.

About a year after its first attempt to audit the National Ecological Observatory Network, DCAA again audited NEON's proposal. While there was still major inadequacies associated with the proposal, DCAA was able to issue an audit report in September of 2012. Highlights from the audit included:

- Of the $433,798,768 proposed by NEON DCAA questioned $102,139,400 and unsupported $52,298,348. Of the $102 million questioned, about $72 million related to contingency costs which as noted later, were not questioned in the system audit based on additional research. Questioned costs are costs the auditor considers not acceptable for negotiating a reasonable contract price or not acceptable for reimbursement under existing contracts. Unsupported costs denote instances where the contractor has not provided specific evidence or documentation to support assertions related to the cost of future work.

- NEON did not provide adequate documentation or support to demonstrate the allowability, allocablility or reasonableness for a significant amount of the proposed direct labor, material, equipment, and other direct costs.
- The inadequacies noted in our audit report were significant enough for us to recommend that the proposal should not be considered acceptable as a basis for negotiating a fair and reasonable cooperative agreement price.

It is also important to note that our proposal review of NEON was different from the normal forward pricing reviews we perform for DoD and other Civilian agencies. First, we were asked to review the proposal more than 7 months after the cooperative agreement had been awarded and a price established. The normal process is for contracting officers to request the audit of a proposal before the award is made. This process allows for the contracting officer to make full use of the auditor's recommendations to negotiate a fair and reasonable price.

Second, we normally work with the contracting officer responsible for awarding the contract action. As described above, the results of our proposal audits are used by acquisition officials to negotiate fair and reasonable prices. In this case we were asked to perform the effort for the NSF Inspector General. However, the ability to implement any of our recommendations or make any changes to the cooperative agreement rests with the contracting officer.

Accounting System Examination – At the request of the NSF Inspector General DCAA performed a review of NEON's accounting system, issuing our report in October of 2014. Our audit disclosed a material noncompliance with NEON's timekeeping system; specifically, NEON's actual timekeeping practices do not comply with its written policies and procedures.

Our audit also disclosed two other material noncompliances that were corrected during the course of our field work. First, NEON failed to comply with the OMB Circular A-122 requirement that organizations receiving more than $10 million in Federal funding of direct costs in a fiscal year must break out indirect costs into two broad categories: *Facilities and Administration* before developing indirect rates. Prior to our audit, NEON had reported these indirect costs together. Second, our audit determined that NEON excluded unallowable costs from the G&A base. The OMB Circular A-122 requires unallowable cost be included in the G&A allocation base so they absorb their share of an organization's indirect expenses. Our fieldwork verified that NEON corrected both of these conditions after we identified them.

In addition to our audit report on the accounting system, DCAA provided the NSF supplemental information regarding both NEON's accounting for contingencies and NEON's use of the management fee it earns.

Although our accounting system report did not identify NEON's treatment of contingency costs as a deficiency, DCAA invested a significant amount of time examining NEON's accounting and estimating of contingency costs as specifically requested by the NSF Inspector General. DCAA found that NEON utilizes a process for identifying potential risks to performance (budget, schedule and scope) when estimating contingency costs for budgeting purposes on NSF cooperative agreements in accordance with NSF guidance. Amounts budgeted for contingency are not allocated to the awardee initially, but are held in reserve by NSF management until the awardee justifies the need for additional funding due to contingencies. After the NSF allocates the additional funds to NEON and NEON incurs an expense it pays for with amounts from the contingency budget, the cost is recorded on NEON's books as an actual expense to a project (e.g. labor or material). This practice complies with OMB Circular A-110 which is not specific on contingency expenditures or the tracking of those expenditures. However, we did recommend that NSF consider strengthening its Grant Policy and guidance to awardees to improve internal controls over contingencies on construction projects with regard to estimating, monitoring, and accounting for contingency expenditures. Specifically, have NSF require an awardee to (i) separately track, (in more detail than what the contractors are currently doing) the use of the proposed contingency costs in the budget control log as a condition of the award, and (ii) provide fully supported bases of estimate for contingencies. This should provide NSF with better oversight of how the contingency is used.

We also provided the NSF Inspector General with supplemental information related to NEON's use of the management fee it earns under the cooperative agreement. Based on our observations during the accounting system review, NEON and NSF negotiated a "management fee" in the cooperative agreements that NEON uses to pay non-reimbursable costs incurred by NEON. The NSF Proposal Award Policies and Procedures Guide and the NSF Grant Policy Manual address fee in general terms, making it clear that fee is permissible if approved by the grants/agreements officer, which it was. We can find no regulation that prohibits the payment of a management fee under a cooperative agreement to a non-profit entity. The management fee established for this cooperative agreement is 0.5 percent, which is at the low end of NEON's stated policy of assessing fees of 0.5 – 1 percent on NSF projects.

However, we were unable to find any NSF Grant Policy determining when a fee should be awarded or how a negotiated fee should be used by a non-profit entity. We also found expenses being incurred that would ordinarily be unallowable under OMB Circular A-122 if they had been paid for separately as costs (for example, $56,000 for lobby costs and $19,000 for a holiday party).

DCAA recommended that NSF consider strengthening their Grant Policy to specify requirements for determining and monitoring the award of fee. NSF should benchmark with other federal agencies to determine how they use management fee and how other agencies allow the use of that fee.

Financial Oversight at DoD Non-Profit Companies – The Department of Defense has established comprehensive procedures for providing oversight to non-profit companies under their cognizance. For example, DoD has established a management plan (see Department of Defense Federally Funded Research and Development Center Management Plan, dated April 25, 2011) that provides extensive guidance and procedures for the management, oversight, and use of FFRDCs. An important aspect of the management plan requires close monitoring of the types of costs that are being incurred as a fee to assure they are appropriate and directly or indirectly benefit the federal agency. The monitoring process includes both a budgeting process where the specific costs are identified in advance, and an annual review of the expenditures to assure that the prior representations and justifications were reliable. This type of close monitoring is not readily apparent in the NEON cooperative agreement.

DCAA is an important component of that oversight and we work closely with the Department's acquisition community providing auditing and financial services.

Finally, based on our experience with other nonprofit companies and contractors in general, we believe there are additional opportunities for NSF to strengthen their oversight of contracts and contain costs. First, for all significant or high risk awards, NSF should obtain an audit of contractors' forward pricing proposal prior to negotiating the price. These audits provide important cost information to the contracting officer and can prove instrumental in arriving at a fair and reasonable price for the contract action provided they are incorporated into the acquisition or grant process and all parties have a common understanding of what audit work is required. Forward pricing audits can be especially helpful in a sole source environment (similar to the subject NEON award) where there is limited or no competition.

Second, for all flexible priced awards (i.e., cost-type contracts) NSF should require contractors to submit annual incurred cost submissions and obtain an audit of significant submissions. It is our understanding that NEON has no contractual requirement to submit annual incurred cost submissions to NSF beyond the annual Indirect Rate Cost submission. A more comprehensive incurred cost submission would also cover direct costs. Incurred cost reviews are an important part of ensuring that costs are properly supported, indirect rates are accurate, and the Government is not paying for unallowable costs.

Closing

Let me assure you that we are committed to providing NSF and all civilian agencies with high-quality audits that protect the interests of the American taxpayer. As we go forward, we intend to work with NSF Acquisition and the NSF Inspector General through the normal contracting process to provide comprehensive contract audit services for NEON and other NSF contractors.

I appreciate the opportunity to testify before you today and I will be glad to respond to your questions.

Ms. Anita F. Bales
Director
Defense contract Audit Agency

Ms. Anita Bales was appointed as the Director, Defense Contract Audit Agency on August 31, 2014, and is responsible for all matters related to the management of the Agency and its resources. In that position she is responsible for managing the worldwide operation of the DCAA and its resources.

DCAA performs contract audits for DoD and provides accounting and financial advisory services regarding contracts and subcontracts to all DoD Components in support of national defense. These services are provided in connection with negotiation, administration, and settlement of contracts and subcontracts. Ms. Bales, through an executive team, exercises executive direction for a staff of over 5,000 personnel, 85 percent of which are professional auditors, with a $600 million annual operating budget. As the Director, Ms. Bales directs the planning, development, execution, and evaluation of comprehensive programs to implement public law and Secretary of Defense Directives in carrying out the contract audit mission assignment to the Agency.

Ms. Bales entered the Senior Executive Service in November 2006

CAREER CHRONOLOGY:
- April 2011-August 2014: Deputy Director, Defense Contract Audit Agency, Ft. Belvoir, VA
- Nov 2006-April 2011: Deputy Auditor General, Forces and Financial Audits, Army Audit Agency, Alexandria VA
- Oct 2001 – Nov 2006: Program Director, Financial Management Audits, Army Audit Agency, Alexandria, VA
- Sep 1998 – Sep 2001: Audit Manager, Force Management Audits, Army Audit Agency, Ft. Belvoir, VA
- Jun 1996 – Aug 1998: Student, Syracuse University

- Mar 1992 – Jun 1996: Audit Supervisor, Central Region, Army Audit Agency, St. Louis, MO
- Jan 1988 – Mar 1992: Auditor: European Region, Army Audit Agency, Frankfurt, Germany
- Aug 1983 – Dec 1987: Auditor: Midwest Region, Army Audit Agency, Rock Island, IL

COLLEGE:
- MBA, Syracuse University
- BS, Business Administration/Accounting, Drake University

SIGNIFICANT TRAINING:
- Federal Executive Institute, Leadership in a Democratic Society
- Syracuse University, Army Comptrollership Program

CERTIFICATIONS:
- Certified Public Accountant
- Certified Information Systems Auditor
- Certified Government Financial Manager

AWARDS AND HONORS:
- Neil Ginetti Award for Outstanding Performance in Financial Management, Professional Development, Career Management and Mentoring
- President's Council on Integrity and Efficiency Award for Auditing
- Leonard F. Keenan Award (Syracuse University)
- Resource Management Award from the Assistant Secretary of the Army (Financial Management and Comptroller)
- Commander's Award for Civilian Service
- Achievement Medal for Civilian Service

PROFESSIONAL MEMBERSHIPS AND ASSOCIATIONS:
- Association of Government Accountants
- American Society of Military Comptrollers
- Association of the U.S. Army
- Professional Advisory Board for Drake University's School of Accounting

Chairman SMITH. Thank you, Ms. Bales.

Let me recognize myself for five minutes for questions. And while I will direct my first question to Ms. Lerner, Ms. Bales, if you will respond as well and we will go back-and-forth.

Ms. Lerner, the question is this: In my opening statement I cited a number of examples of what I would consider to be a misuse of management fees. And let me just focus on one. By the way, the total cost of this misuse of management fees in my opinion is close to a half a million dollars. I mentioned one. Let me go back to that. And that was a holiday party last year that cost $25,000, which amounted to about $140 for every person who attended. Other agencies have written rules against using taxpayers' dollars for these types of expenditures. Does the National Science Foundation have any similar kind of rule, and if not, why not?

Ms. LERNER. I am not aware of any specific rules that the Foundation has. Obviously, cost principles that would apply to the awards that are funded by the Foundation would generally prohibit expenditures on parties and food.

Chairman SMITH. Okay. Thank you. And, Ms. Bales, do you want to add anything to that? I might add that, for instance, NASA has a rule that prohibits use of dollars for anything like this and other agencies have similar types of rules. But do you have any recommendations for the National Science Foundation?

Ms. BALES. We—in terms of the holiday party, it was covered by the management fee——

Chairman SMITH. Yes.

Ms. BALES. —and because that is not considered a separate cost, we didn't look at it as a separate cost and looked at it as the management fee. If the fee had been—if the cost of the holiday party had been reported separately, we would have questioned that. Our recommendation would be to look at the use of management fees and what is covered by management fees.

Chairman SMITH. It is my understanding that for the last several years the National Science Foundation has been on notice that a lot of its management fees were being used in ways that would not be considered appropriate and has ignored past audits at least until a few days ago when I think because of this hearing they decided to look at some of their practices. In any case, the fact that they were warned for several years and did nothing is troublesome to me. Do you see the National Science Foundation as following best practices when it comes to the use of management fees, Ms. Lerner?

Ms. LERNER. Our office, in an attempt to eliminate a kind of murky issue, prepared a white paper that looked at the history of management fees in the Federal Government. They go back about as long as I do, to 1960s, and because of the lack of clarity about what management, they are intended essentially to help entities that primarily do business with the Federal Government and that in order to maintain financial viability need to have some ability to be reimbursed for expenses that would ordinarily be un-reimbursable.

Chairman SMITH. Okay.

Ms. LERNER. So they are intended to reimburse un-reimbursable expenses, but there has been controversy over time because no one has set limits on what those normal and ordinary expenses should be and sometimes you find situations——

Chairman SMITH. Don't most agencies set limits but the National Science Foundation has not?

Ms. LERNER. I don't know that anyone has concrete limits. I know some people—the Department of Defense looks very carefully at the amounts that are proposed. I don't know that they set actual limits. We did not identify any concrete limits on what you could use a management fee for in our effort to assess——

Chairman SMITH. Okay.

Ms. LERNER. —the landscape.

Chairman SMITH. Other than an example—in the specific examples that I gave you, clearly those would be inappropriate if they had been itemized——

Ms. LERNER. It is hard for me to see that a holiday party is a normal and ordinary operating expense.

Chairman SMITH. Okay. Thank you.

Ms. Bales, let me ask a couple questions and direct them to you first. Let's go to the subject of construction contingency. That is normal practice. You set aside a certain percentage for contingencies, 18, 19 percent, sometimes 20 percent. But what is different about the National Science Foundation here? And if you will go into a little bit of detail in regard to NEON, their contingency I think started at $60 million, went up to $74 million. To my knowledge those expenses were not justified, were not itemized, and were not documented, which I think is fairly highly unusual. But if you will just comment on the practice of the National Science Foundation when it comes to the way they handle the construction contingencies.

Ms. BALES. The National Science Foundation has guidance that allows for the use of contingency in budget, so as part of their budget process, they will include here is the cost and then here is an amount for contingency. And when that money has been awarded—or the cooperative agreement or a grant is awarded, the money goes to the awardee and then the—there are practices in place where if there has to be, say, the limit is over 250,000 and it needs to be reallocated, that then has to be improved by—approved by NSF management. So——

Chairman SMITH. And what about the increase from the 60 to 74 and was that documented or was that—were they sort of operating without many rules and restrictions?

Ms. BALES. The—we did the proposal audit and looked at those contingency fees. Part of the issue was the basis for how much was being included in the contingency was not well documented.

Chairman SMITH. Okay. Thank you, Ms. Bales. That concludes my time.

The gentlewoman from Texas, Ms. Johnson, is recognized for her questions.

Ms. JOHNSON. Thank you, Mr. Chairman.

Ms. Lerner, on August 21, 2014, the Office of the Inspector General of the Department of Defense released an evaluation of DCAA's quality control system. The review found numerous instances where DCAA failed to properly document its audit conclusions, as required by the generally accepted government auditing standards and the statements on standards for attestation engagements of the American Institute of Certified Public Accountants. This resulted in DCAA receiving a rate of "pass with deficiencies" indicating that DCAA still has serious work to do in order to fully comply with the relevant professional standards.

On September the 8th, 2014, the DOD IG released a report that found one or more significant deficiencies in over 81 percent of DCAA's audits from Fiscal Year 2012 and 2013 sampled as part of the review. On September the 17th, 2014, Kellogg Brown & Root Services Incorporated, KBR, filed a suit against the United States Government in federal court seeking to recover $12.5 million in legal fees incurred by KBR in defending against findings from a flawed DCAA audit. Were you aware of these significant adverse findings regarding the quality of DCAA's audit work and are you at all concerned with relying on DCAA audit findings in your own work?

Ms. LERNER. I would say a "pass with deficiencies——

Ms. JOHNSON. I am sorry?

Ms. LERNER. Sorry about that. A "pass with deficiencies" is not the outcome that anyone would seek in a peer-review process so that is a matter of concern. But when our office has DCAA do work for us, we have audit monitors that oversee the work that they do to—and, you know, I feel that if they had identified issues, we would have followed up with DCAA and attempted to ensure that those concerns were addressed. So it is a matter of concern but I do think we have some controls in place where we attempt to ensure the quality of the work that is done for us.

Ms. JOHNSON. Ms. Bales, committee staff have heard from numerous entities audited by DCAA auditors in the last few years that there were significant communication problems that resulted in millions or hundreds of millions in questioned costs that in some cases have already been resolved down to a few hundred thousand dollars. We have heard the same type of complaints from all of these entities, namely that the auditors were unclear or incompetent in their request and that they failed to work with an audited entity in a transparent way that might easily have resolved the misunderstandings that led to significant questioned costs.

In the meantime, the reputation of world-class research institutions have been put at risk. Given that there is one common party here and that is DCAA, I am inclined to attach significant weight to these complaints and I am concerned that DCAA does not have the staff expertise or experience with grants and cooperative agreements or with the science construction projects. Are you aware of these complaints from these entities audited by your agency on behalf of NSF IG or have you taken any steps to address the concerns going forward?

Ms. BALES. I am not aware of the specific complaints that you are referring to from the NSF entities that we have audited. No one has raised those to me. However, over the time frame we have entered and issued what we call rules of engagement to our audit staff that does encourage them to communicate with both the contractors or grantees that we audit, as well as the contracting officers to make sure that as we go through our audits, everyone is aware of what we are doing, that we issue draft reports and findings and have those discussions as we go along so that if there are issues, that maybe misunderstandings, that we have those discussions as we go through.

If specific complaints do come to my attention, we respond to those and look through them and see is there really a valid complaint there and how do we work through that?

Ms. JOHNSON. So you have not heard of any of these complaints?

Ms. BALES. Not the specific—I mean you are talking complaints specific to NSF, correct?

Ms. JOHNSON. Yes.

Ms. BALES. Yes. No——

Ms. JOHNSON. And you haven't heard about any of them?

Ms. BALES. None of the NSF awardees have come to me to say that my auditors are not working with them and that they are not understanding what we are saying.

Ms. JOHNSON. Thank you. I yield back.

Chairman SMITH. Thank you, Ms. Johnson.

The gentleman from California, Mr. Rohrabacher, is recognized for his questions.

Mr. ROHRABACHER. Thank you very much, Mr. Chairman.

And, Mr. Chairman, I would like to thank you for holding this hearing. I think that our oversight responsibility is of tremendous importance to the people of the United States. If they are to have faith in their government and faith in this Congress, they have to know that we are doing our job and this oversight hearing is part of the job and the task of these witnesses today is to ensure that the American people know that their hard-earned money is not being wasted.

And quite frankly, attacking the people who are doing an investigation is not a refutation of the findings of an investigation or does it justify any type of, let's say, holding back on the part of investigators. In fact, we should be encouraging our investigators rather than try to find fault with them. Let's find out whether or not what they have to say is something that is going to be significant to the taxpayers or not.

In this case, what we have here is 36 percent of a budget was found to be—have an unacceptable level of accounting. This budget was 435—$434 million and that is a very significant sum for American people who are struggling to make—to pay their own bills at home. So we—no one should be making light of this or trying to focus their efforts on undercutting the people who are trying to see if we are spending our money correctly or not for our taxpayers' money correctly or not.

Now, it seems to me that what we have here—this is not—a complaint over on the other side of the aisle seems to be that this was too late and it was premature at the same time, this investigation. Well, I guess too late and premature means it was just about right.

So let's get down to some of the details here. Let's make it very clear, the money that we are talking about here, this 36 percent of the budget, that money, out of a $434 million budget, that reflects money that comes directly from National Science Foundation research funds, does it not?

Ms. LERNER. It does.

Mr. ROHRABACHER. Okay. So what we are talking about here——

Ms. LERNER. Well, MREFC funds.

Mr. ROHRABACHER. Okay. Well, so what we are talking about is important research funds that have been allocated for research that may have been going to lavish parties, to trips to various places, lobbying—as well as lobbying efforts, that we are using taxpayers' funds for lobbying efforts and lavish Christmas parties. This is very much important for us to look into—because it sends a message to other government agencies that we don't want—not only do we not want our research funds misused but we don't want any government funds to be misused simply because we are going through contractors here.

Let me ask Ms. Lerner. When your office raised this—these issues with the National Science Foundation about the concerns about this major research facility costs and the costs described in your testimony, has the National Science Foundation done anything in response to your findings rather than trying to attack you as the investigator?

Ms. LERNER. They have made changes. They—when we started looking at contingency amounts, initially the threshold for which NSF approval had to be sought was $250-$200,000 for many awardees, so, you know, most amounts were under that. When we surfaced this issue, NSF did lower the amount that——

Mr. ROHRABACHER. Okay. So now people don't have as much——

Ms. LERNER. —required approval.

Mr. ROHRABACHER. People don't have as much discretion——

Ms. LERNER. Exactly.

Mr. ROHRABACHER. Okay. That is fine.

Ms. LERNER. So they did do that.

Mr. ROHRABACHER. Well, did you find that the National Science Foundation either explicitly or implicitly allowed NEON, the group that we are talking about now, this contractor that we are talking about, to use these management fees for lobbying and—or liquor or lavish Christmas parties or any of the other expenditures that are very questionable?

Ms. LERNER. The record seems to—you know, the record reflects that NSF approved a management fee for NEON and NEON used that management fee for——

Mr. ROHRABACHER. Did they know when they approved it that there—that it was going for questionable purposes or is this—or they didn't know?

Ms. LERNER. I believe the first tranche of management fees, the first year's worth were paid after the fact and there was—so in—there was some awareness on NSF's part for what those expenditures were for. In subsequent years, they were provided a percentage and I don't know that the agency had clarity as to how the management fees were used in those years.

Mr. ROHRABACHER. Yes, sometimes there is a willful amount of knowing certain wrongdoing is going on.

And, Ms. Bales, the—has the DCAA ever identified the use of management fees for lobbying?

Ms. BALES. No, we haven't.

Mr. ROHRABACHER. Okay. Well, thank you very much. Thank you, Mr. Chairman, again, for holding this hearing.

Chairman SMITH. Okay. If the gentleman will yield, and I know his time is up, that is a subject for us to revisit because about a quarter of a million dollars was spent in lobbying fees, and had it been itemized, I think it would have been very, very improper. But we will get to those distinctions in a minute.

The gentleman from Massachusetts, Mr. Kennedy, is recognized for his questions.

Mr. KENNEDY. Thank you, Mr. Chairman, thank you to the witnesses for appearing today.

And I want to echo the comments of the Ranking Member in her opening statement indicating that there are some very much legitimate oversight issues that the Committee can be pursuing with regard to the management and cooperative agreements for large facilities at NSF. I do wish that NSF was a—had been—was here today and that I understand that some of the reports that we are discussing are preliminary. And so I hope that there will be another opportunity to dive into this in a more comprehensive way rather than just being able to touch on the initial findings at this point and making sure that there is a balance to the hearing.

Ms. Lerner, if I can direct the first question at you. You had mentioned in your testimony the need for projects such as NEON to obtain updated cost estimates before being approved for funding by the agency. The design and development of any large facility accounts for roughly ten percent or more of the total project costs I believe. At NSF these costs are deducted by—from the research account, I think as one of my colleagues pointed out, which means that there are in fact fewer research grants. Some significant fraction of that cost is developing rigorous cost estimates, so estimates in order to make those—for those studies.

Even if we use a conservative estimate, about 10 to 20 percent of those design costs, you are still talking about millions of dollars a year. Updating those estimates takes a significant amount of time, effort, energy, financial resources, money, perhaps sometimes months because it requires project management to go back again into each and every one of the vendors and continue to redo these estimates.

So when it comes to managing project risk, isn't there a trade-off between approving potentially outdated cost estimates and the increased cost and time required to update those estimates over and over and over again, particularly for a major project for final design review? There is also analytical tools available to develop reasonable costs and models for escalation for final proposal, and NSF I believe makes use of those tools, so any estimates that are—it is still just an estimate when there is obviously some risk involved.

In the final analysis NSF has concluded that the trade-off that I have mentioned favors moving forward with the project even with price quotes that might be a bit outdated. Have you come to the—you have seem to have come to the opposite conclusion and I would just like to understand how you arrived at that conclusion. Is there any OMB guidance on a date of expiration for those cost estimates for construction projects? It says after 6 months, a year, 18 months that it should be reevaluated?

Ms. LERNER. I am not aware of any specific hard and fast time frame but I do think that some of the concerns that we—that were found in the audits that were conducted for us were when estimates were used that were 4 and 6 and eight years old and——

Mr. KENNEDY. What—if I can ask——

Ms. LERNER. Um-hum.

Mr. KENNEDY. —what do you think would be a reasonable time frame in order to reevaluate those costs? Would it be 6 months, a year, two years. Do you have some basis in there to say—or are there external factors that you look at——

Ms. LERNER. You know, I——

Mr. KENNEDY. —the economy, inflation? What triggers that reanalysis?

Ms. LERNER. I think it is probably not a one-size-fits-all because different costs you have to look at differently, but I would say, you know, you wouldn't want to go—I think you could definitely go back a year and potentially even two years, but when you are back much beyond that, then the quality of the estimate is weakened. And I think the important thing is when a final decision is made to fund a project that you have a really good sense of what that project is going to cost. And what we have seen is, because of the risks, one of the reasons that we have large amounts of contingencies is to address uncertainties with respect, you know, to costs over time. And so——

Mr. KENNEDY. So I understand you correctly just so that I do, you are saying that there is essentially no one size fits all, that it is a—and no particular factor that you can point to to say this should trigger a reevaluation or not but kind of a totality of the circumstances, evaluation of it. Do you have—can you point to any particular factors that would go into that analysis to provide some guidance to NSF or anybody to say these are the factors that we should be looking for before we make this reevaluation?

Ms. LERNER. Certainly. I think you want to look at the age of the estimates, you want to look at the quality of the estimates. Sometimes there were costs that were questioned because there was—the cost was—a portion of it was supported by an estimate but a portion of it was just kind of someone's best guess as to what things would cost. And so the more you are relying on concrete cost-related data to support your costs, the more—the greater the likelihood is that you will have a good idea of what those costs should be.

Mr. KENNEDY. So you are calling into question the underlying—the initial estimate because you are saying that wasn't done properly?

Ms. LERNER. In some instances.

Mr. KENNEDY. Okay. Chairman, I yield back.

Chairman SMITH. Thank you, Mr. Kennedy.

The gentleman from Indiana, Mr. Bucshon, is recognized.

Mr. BUCSHON. Thank you, Mr. Chairman.

Ms. Lerner, were the—these reports preliminary, as has been described, the reports that you have done?

Ms. LERNER. The audits that were issued by DCAA were not preliminary. There were some initial inadequacy memos but then the final 2012 audit was final and the accounting system audit is final as well.

Mr. BUCSHON. Okay. So to clarify again the reports are final reports, not preliminary——

Ms. LERNER. Correct.

Mr. BUCSHON. —evaluations. And as far as that goes, does—do—whoever wants to take this, did the NSF know that money was being spent for lobbying services?

Ms. BALES. I believe that there was—in the first year of the management fee in the NEON project there was a statement that certain funds would be used for government outreach I think was how it was characterized. I don't know if that—if NSF read that and understood that to mean lobbying. I am not sure that they saw more than that particular document.

Mr. BUCSHON. Okay. So that information was available about—I mean I have the breakdown here in front of me.

Ms. BALES. Right. That is from the accounting records of NEON.

Mr. BUCSHON. That is available.

Ms. BALES. Yes.

Mr. BUCSHON. I don't have any other questions but I will make a brief comment.

I am looking forward to the next Congress and the testimony that will be provided to the Committee by NSF. As most of you know, I was the Chairman of the Research and Technology Subcommittee, and on that subcommittee there has been some resistance from National Science Foundation as it relates to transparency and I hope that that does not continue. For example, in some instances we have been asked to come to National Science Foundation to review documents rather than have them released, and at that time much of what is in the documents has been redacted.

And so I do think that Congress has a very important oversight role and I fully support the National Science Foundation's ability to make judgments on which scientific studies should be funded. All I think we are asking for is the justification and that is part of our oversight, which is extremely important.

With that, Mr. Chairman, I yield back.

Chairman SMITH. Okay. Thank you, Dr. Bucshon.

The gentlewoman from Oregon, Ms. Bonamici, is recognized for her questions.

Ms. BONAMICI. Thank you very much, Mr. Chairman. And thank you to both of our witnesses for being here at the committee today.

There are few issues that spark the ire of our constituents more than the potential misuse of their hard-earned tax dollars, and we hear about that, so I hope at least we can clear up some of those concerns today. I do want to start by aligning myself with Ranking Member Johnson's comments and Mr. Kennedy's comments about the need to have a more balanced hearing to hear from the NSF, so I want to say that I hope we can really have a more balanced look at this situation.

I want to say that the National Ecological Observatory Network, NEON, is an ambitious project, we know, with the potential to yield significant advancements in our understandings about how humans interact with the planet, including the potential threat posed by invasive species. This includes collaborations with academic researchers across the country like at Oregon State University in my home State where they have looked at the impact of temperature variability on the release of carbon from soils. Deepening our understanding of the Earth's natural processes and the impacts that human beings can have on those processes is essential and I hope that this hearing will yield some constructive solutions to assist the NSF in developing NEON. So I don't want us to lose sight of the importance of NEON.

I want to start with Ms. Lerner. In your testimony you stated that when DCAA notified you about the use of a management fee for unallowable services, you referred the matter to the United States Department of Justice but they declined to accept the case. Were you given any reason from the DOJ to explain why the case was not accepted?

Ms. LERNER. I don't believe that we were. I mean sometimes, you know, there are any number of reasons that the Department of Justice chooses not to proceed with an investigation. And I don't recall that we received express—explicit feedback on that point.

Ms. BONAMICI. And I want to follow up on Ms. Johnson's line of questioning a bit earlier. In preparing for the hearing, I heard concerns from various entities that DCAA may not have the technical competency to accurately assess a major science construction project like NEON. And as—you know, and with due respect to Ms. Bales, DCAA was established to audit DOD contracts. And in fact when I was reading Ms. Bales' bio, it really talks about the Department of Defense. So did you ever consider having a different auditor look at—into this particular project? Can you follow up on that a bit and discuss that?

Ms. LERNER. At the point at which we were doing these audits, we were primarily using DCAA for that type of audit support. We have other options now. But I would say I have heard many concerns, some raised in this hearing, about the approachability and the interactions that DCAA auditors had with NEON and with other auditees, and I went back and spoke to our monitors and I just want to clarify that there was a great deal of conversation and back and forth between my staff, the Foundation's staff both from the program and from the Budget, Finance, and Accounting Division, NEON, and DCAA about what the purpose of the audits were, what the findings were.

When we had these series of proposal audits done, that all came to a conclusion with a lack of—with real concerns raised about contingencies. In particular, we heard back from the auditees. We have the information. DCAA didn't ask the right questions or talk to the right people, and so we said all right. If there was—a process fail, we will go back. So, we sat down, all of us, and talked about those three awards and we went back to each of the entities to do a deeper dive. And we had a great, you know, people from all the concerned parties around the table at the initial deeper dive. We sent audit folks to Denver to meet with the NEON staff, DCAA representatives were there, NSF folks and additional people from our office filed in from Boston and I believe even the financial statement——

Ms. BONAMICI. Ms. Lerner, I don't mean to cut you off but I want to——

Ms. LERNER. Right.

Ms. BONAMICI. —I just have a few seconds left——

Ms. LERNER. Sure. Sorry.

Ms. BONAMICI. —and I want to ask——

Ms. LERNER. There was a lot of communication.

Ms. BONAMICI. I understand. Ms. Bales, during the initial audit of NEON's accounting systems, DCAA found eight instances of non-compliance with federal requirements, including the use of management fees for some unallowable costs. But in the final 2014 audit only one instance was included and that focuses on timekeeping and did not mention management fees. Can you explain why the initial findings did not make it into the final report?

Ms. BALES. Specifically to the management fee, that was really not with—totally within the scope of an accounting system, but once we saw that the management fee was being used for those type of expenses, we can't not report that. So we reported that in a separate memorandum and—rather than including it in the report related to the accounting system because of the scope of what an accounting system audit is. And the other findings—we identified two findings that had been corrected by NEON during our fieldwork and there were other findings that, as we looked through the supervisor review process, that there needed to be additional work and that work was done and they were not continued to be supported.

Ms. BONAMICI. Thank you. And my time is expired. I yield back. Thank you, Mr. Chairman.

Chairman SMITH. Thank you, Ms. Bonamici.

The gentleman from Kentucky, Mr. Massie, is recognized for his questions.

Mr. MASSIE. Thank you, Mr. Chairman.

This question is for Ms. Bales. Given the number of issues that were discovered in the NSF audits, how does that compare with other audits that have been done by DCAA?

Ms. BALES. Other audits just in general or——

Mr. MASSIE. Like other agencies, do they have a similar number of issues that are significant or questionable with unsupported costs?

Ms. BALES. It is really very different based on——

Mr. MASSIE. I mean——

Ms. BALES. —contract to contract, organization to organization, and it really—it is hard to make a general conclusion in terms of the number of problems because there is just such a wide range of different types of audits that we do and different contractors. We do frequently find issues as we go through contracts in terms of the same number. That is really hard to answer.

Mr. MASSIE. In general though, were these—do you find this across government? Is this an epidemic that we have?

Ms. BALES. When you say "this," do you mean the——

Mr. MASSIE. The——

Ms. BALES. —management fee type issues or——

Mr. MASSIE. Yes, all of the things that you found in the audits—that were found in your audits.

Ms. BALES. We do find—frequently we find problems with accounting systems and we work through those. We find—often, you know, one of the things is we are working through a lot of proposals. We have a lot of inadequacies. As we talk with other contractors, we say one of the things that you as the contract community can really help us out in doing our job is making sure that your proposals are adequate. So it is—different inadequacies in proposals are common.

Mr. MASSIE. Well, let's talk about the proposals then. Is it normal to audit a proposal and then have that proposal accepted before the audit is finalized?

Ms. BALES. Normally, no, because again as—the purpose behind——

Mr. MASSIE. Why was that done here then?

Ms. BALES. When we accepted the audit and in talking with the NSF IG, there was still the ability—even though the cooperative agreement had been awarded, there was still the ability to have an impact on the price so they could go back in and make an adjustment. But normally we would do that ahead, before the negotiation happens on the issuance of a contract or grant or an award because, as we look at that proposal and we find different things to question or that aren't supported, that provides the contracting officer or the grant manager the ability to go into that negotiation with information that allows them to really do a good negotiation to get a fair and reasonable price. If the contract had been finalized and there wasn't the ability to reopen and go in and make adjustments to the price, then we really wouldn't have a value to add in reviewing a proposal after it had been awarded. But there was, as the IG indicated to us, an ability to go back in and affect the amount of this cooperative agreement.

Mr. MASSIE. Okay. This question is for Ms. Lerner or Ms. Bales or both. In reviewing the audits, what appears to be the source of the issues? I mean is it that—is it NEON for not doing a sufficient job of maintaining the books or is it the NSF for not conducting the responsible oversight? Ms. Lerner, would you care to answer?

Ms. LERNER. I think ultimately the costs proposed are proposed by NEON and they were not supported in ways that they should have been to be compliant with OMB's Circular A–122. I would imagine that NEON would say that what they were doing was compliant with NSF's Large Facilities Manual but, you know, the Large Facilities Manual and the cost principles should both support each other and not to be in conflict.

Mr. MASSIE. So to answer that question, you think it is more on NEON's noncompliance with the standards for accounting?

Ms. LERNER. I mean ultimately it was their proposal.

Mr. MASSIE. Um-hum.

Ms. LERNER. So I think you have to—they have to be the ones—they were the ones who made the proposal. NSF had a role in providing guidance through the Large Facilities Manual but it was NEON's proposal.

Mr. MASSIE. Thank you. And, Ms. Bales, what is your opinion of that?

Ms. BALES. I would agree with Ms. Lerner. In terms of the proposal, it is the responsibility of the service provider to put together a proposal that can't, from our perspective, be audited and allows the contracting officer or grant manager to know what is coming in and be able to make a decision on.

Mr. MASSIE. Thank you. And I yield back 1 second.

Chairman SMITH. Thank you, Mr. Massie.

My colleague from Texas Mr. Veasey is recognized for questions.

Mr. VEASEY. Thank you, Mr. Chairman.

I wanted to ask Ms. Lerner a question. Ms. Lerner, according to the NSF, the agency sustained $20 million in questioning cost from NEON's proposal. This contradicts the statement that you made in your written testimony when you implied that NSF upheld the full proposal in April 2014. NSF further told us that they have been unable to take any steps to reduce NEON's total budget accordingly because you escalated your finding to the agency's audit follow-up official who must now weigh in before any further action can be taken. Were you aware that NSF in fact sustained nearly $20 million in question costs?

Ms. LERNER. We are aware of that now.

Mr. VEASEY. Okay. And also I wanted to ask you another statement that was made a little bit earlier. I understand that you feel very strongly about your views on contingency funds and of course there has been some disagreement, you know, with that. When you had the opportunity to make your case before the OMB, it seems to me that you were overruled. Is there a specific OMB regulation that you believe NSF to be in violation of? And if—and I actually have a copy of the text if Members would like to see it, but I just wanted to get your opinion on that as well.

Ms. LERNER. If you look at the—are you speaking about the new provision in the uniform guidance?

Mr. VEASEY. The—okay. It was December 26.

Ms. LERNER. Yes, it is the uniform guidance.

Mr. VEASEY. Yes, right, exactly.

Ms. LERNER. The change that was made there added a Section B that speaks specifically about the ability to have contingencies in budget estimates and that has never been the concern of my office. Our concern has been with the final provision of that section subpart C, which says payments made by the federal awarding agency to the nonfederal entity's contingency reserve or any similar payment made for events, the occurrence of which cannot be foretold with certainty as to the time, intensity, or with an assurance of their happening, are unallowable.

What we see with contingencies at NSF is that they accumulate them WBF level by WBF level into a large reserve, and those—the contributions to that reserve, many of them don't meet the certainty requirement that is set forth in that subparagraph. And so that has been our concern, not—we have never taken the position that you cannot have contingencies in a budget, simply that when you make a contribution to a reserve, there needs to be certainty as to the factors set forth in the principal.

Mr. VEASEY. Okay. All right. Okay. Well, let me just—can I—if—do you mind, very quickly, if I can just read some of this——

Ms. LERNER. Sure.

Mr. VEASEY. —statement from you a little bit earlier. This is—I am going to read directly. Let's see. "Some commentators recommended additional provisions for further clarity on the types of costs that are allowable for contingencies and recommended additional controls on how federal agencies provide oversight over these funds. In particular, commentators suggested adding a requirement to track funds that are spent as contingency funds throughout the nonfederal entity's records. The COFAR reviewed the language and concluded that it does provide sufficient controls to federal agencies to manage federal awards. The COFAR noted that through a diversity of techniques that are available to establish contingency estimates, the estimates must be based on broadly accepted cost estimating methodologies. Budgeted amounts would be explicitly subject to federal agency approval at time of award and funds will be drawn down unless in accordance with all other applicable provisions of this guidance. The actual costs incurred must be verifiable from the nonfederal entity's records. The COFAR considered this last requirement to be sufficient for tracking the use of funds as contingency funds should be most properly—should most properly be charged not as contingency fund specifically but according to cost category in which they naturally fall. The COFAR did not recommend any changes to the proposed language."

Ms. LERNER. Well, with respect to the statement of that the contingencies have to be verifiable from the nonfederal entity's records, that scenario of where we have had concern because while we can look at a change log and see that the awardee says that they are going to expend contingencies in certain amounts on certain—for certain purchases, we can't verify that those expenditures were actually made in the financial records of the awardees, and so that has been an area of great concern to us.

When you have 30—you know, $77 million worth of contingencies that will be expended but we can't determine how they are expended in the actual accounting records, that is an area of risk because people can say that they are going to expend it one way and then expend it another way and we won't be able to tell. They can also hide, you know, cost schedules with cost—cost overruns in ways that we won't be able to see. So we do have concerns about the ability for the—to verify the expenditures from the nonfederal entity's records.

Mr. VEASEY. Thank you.

Thank you, Mr. Chairman.

Chairman SMITH. Thank you, Mr. Veasey.

The gentleman from Arizona, Mr. Schweikert, is recognized.

Mr. SCHWEIKERT. Thank you, Mr. Chairman.

For many of us here, we start to delve into this and we are concerned because we want to see NSF be successful. I mean this isn't beating them up; this is sort of doing our constitutional duty but also, you know, it is an organization that is important when they—you know, when they hit their mark.

Ms. Lerner, Ms. Bales, how long have you been in shall we say the auditing business?

Ms. LERNER. Well, I have been in the IG community since 1991.

Mr. SCHWEIKERT. Ms. Bales?

Ms. BALES. I have been auditing since 1984.

Mr. SCHWEIKERT. Okay. So you have sort of been doing it forever?

Ms. BALES. Yes.

Mr. SCHWEIKERT. Nothing personal on that. I am actually married to one of your kind so—should I at least be a little bit surprised and maybe I just was a little sensitive to it, some of the reaction of beat up the auditor, I mean how often have you had that experience where instead of digging into saying, okay, here is how we could fix this, it is, no, let's beat up the auditor? I was just a little surprised at the tone of both some of the questions but also some of the things I have seen written. Has that been an experience in the past, I mean shoot the messenger?

Ms. BALES. Well, having been an auditor forever——

Mr. SCHWEIKERT. It is nothing personal.

Ms. BALES. No, that is fine.

Auditors—I mean no one is comfortable when an auditor comes into their house and so we do tend to be a target when things—when people hear maybe what they don't want to hear. So there have been times when, throughout my career, it was like, well, you just don't understand. You don't have the expertise. You are coming in. So it is not unusual to hear that but then it is our responsibility to go back and show this is how we know what we are doing, this is our competence, these are the regulations that we are following——

Mr. SCHWEIKERT. But if you have been doing it since the mid-'80s, sorry, you have probably seen everything. And, Ms. Lerner, have you ever sort of had this sort of personal sort of——

Ms. LERNER. Well——

Mr. SCHWEIKERT. —pushback?

Ms. LERNER. —before I was wearing the audit hat, I was a lawyer so I have experienced pushback——

Mr. SCHWEIKERT. Is that two strikes against you?

Ms. LERNER. Pretty much. One more I don't know what will happen.

So you have to have a really thick skin and a strong stomach to do what we do, and, you know, I——

Mr. SCHWEIKERT. But how do we convince——

Ms. LERNER. —you sign up for it.

Mr. SCHWEIKERT. —our brothers and sisters around here we are actually doing this for love and success and protecting the taxpayers and the agency, and sometimes we have got to have these honest conversation?

Ms. Bales, okay, your specialty has been a lot of defense contracts?

Ms. BALES. Yes. I have been with the Defense Contract Audit Agency for about 3–1/2 years.

Mr. SCHWEIKERT. In modern defense contracts, as you review their success, their compliance, what would happen if it was a defense contractor that was spending money on alcohol and other types—let's call them externalities? Would that be tolerated in—on that side of the world?

Ms. BALES. If we were to audit a contract and see that there was a cost that was reported that was alcohol, use that as an example, we would question that cost as unallowable. And this is one of the differences between FAR 31, which covers the defense world and to kind of respond to the issue about our competency to look at National Science Foundation contractors because they are not defense. We do understand that FAR covers much more in detail than what OMB A–122, which covers the National Science Foundation contractors. But because A–122 does not have that spelled out of what is expressly unallowable as the FAR does, but OSD would respond to the FAR and it would say alcohol is expressly unallowable and we would question that.

Mr. SCHWEIKERT. So this was nothing personal? It wasn't a vendetta——

Ms. BALES. Absolutely not.

Mr. SCHWEIKERT. I mean this is just standard practice of how you would do your job?

Ms. BALES. Correct.

Mr. SCHWEIKERT. In the way you designed your audit, okay, you pointed out the number of sins and the misappropriations and some of the failure to manage the contractor, but within that, didn't you also provide a series of suggestions of how to solve this problem in the future?

Ms. BALES. We did because one of the reasons because there was a management fee and these expenses were covered by a management fee, we did not question them as unallowable because once the management fee has been awarded and there has been a determination from management to attach an award fee—or a management fee in that award, we have to audit to the terms of that collaborative agreement contract grant, and because a management fee was awarded, there are no restrictions on what the management fee can be used for.

Mr. SCHWEIKERT. Well, Mr. Chairman, forgive me for going a few seconds over. Did you audit in depth sort of the design of the contract?

Ms. BALES. The design in terms of——

Mr. SCHWEIKERT. The reporting requirements, the design, the protocols, the mechanics within the agreement?

Ms. BALES. I would say we don't audit that in depth because our——

Mr. SCHWEIKERT. If you—from what you have seen, should we go back and delve into those contracts and really break them open and do a sort of a forensics within those contracts?

Ms. BALES. In terms of what costs were incurred, you know, we would, at the end of any cost type contract, we would advocate that a good oversight is to come in and do and incurred cost audit that covers both indirect and direct costs to make sure that the costs were in accordance with guidance and in accordance with the agreement.

Mr. SCHWEIKERT. And so that is something we can look forward to in the future?

Ms. BALES. We could.

Mr. SCHWEIKERT. All right. Thank you, Mr. Chairman.

Chairman SMITH. Thank you, Mr. Schweikert.

The gentleman from Texas, Mr. Weber, is recognized.

Mr. WEBER. Thank you, Mr. Chairman.

Actually, this is a question—well, first of all, let me just say to Ms. Lerner and Ms. Bales, you all do this for a living, is that right? Do they pay you to do this?

Ms. LERNER. Yes, sir.

Ms. BALES. Yes.

Mr. WEBER. Okay. Do they take—and I don't mean to pry. Do they take taxes out of your paycheck?

Ms. LERNER. Yes, sir.

Ms. BALES. Yes, they do.

Mr. WEBER. Okay. And you are okay if they double the amount they are taking out or would you rather government be run as effectively and efficiently as possible to mitigate any taxes they might take out of your paycheck?

Ms. LERNER. Well, you know, we are in the business of trying to pursue an efficient government.

Mr. WEBER. That is a simple yes.

Ms. LERNER. It is.

Mr. WEBER. Yes.

Ms. BALES. Efficiency, effectiveness, this is what we look at.

Mr. WEBER. Absolutely. So you have a vested interest when you are doing this. And there is something called generally accepted accounting principles—or what do you all call that, GAAP?

Ms. LERNER. Yes.

Ms. BALES. Yes.

Mr. WEBER. Okay. And so you all are experienced in that. And so when you go in and you look at this way, it is kind of like David Schweikert, my colleague over here said, you know, we are doing this for the right reasons. We want to make sure that our taxpayer dollars are expended in the wisest, best—bestest use. That is probably not good English but that is what we want. And so I appreciate you all doing that and I, too, echo his comments. It saddens me that sometimes the messenger gets shot in that endeavor, but thank you for doing that.

It seems as though it should be a standard operating procedure for any federal agency that commits 400 or more billion dollars to a construction project to have a cost proposal audit and resolve those problems before that construction begins and then also to have a post construction audit of actual expenses. Now, that just seems to be a good generally accepted accounting principle to me. I own an air-conditioning company; I am a business guy. Would you all agree with that?

Ms. BALES. I would. In terms of what we do our audits, we think that we can add good value before the audit is awarded by again providing information to the contracting officer to be able to go in with a good negotiating position and then after the fact to make sure that the costs were accurate and allowable, reasonable, and allocable.

Mr. WEBER. Okay. I may have misspoke, 400 million, I am sorry.

Ms. BALES. Yes.

Mr. WEBER. But go ahead. You know, 400—a billion here, a billion there, it is real money. Ms. Lerner, what do you think?

Ms. LERNER. I agree. And we have made both of those recommendations to the Foundation for its large, high-risk, high-dollar construction agreements. You know, step up the—both the pre- and the post-award oversight.

Mr. WEBER. Are there plans to perform an incurred cost audit for NEON and the other NSF major projects? Do you know?

Ms. LERNER. You know, do you mind if I look at my—we are looking at management fee for this year——

Mr. WEBER. Um-hum.

Ms. LERNER. —but I would assume that down the road we would consider auditing—doing incurred cost audits in some of these large construction agreements. But we aren't the only ones. The Foundation can also do that. It is not just an oversight responsibility; it is a management responsibility.

Mr. WEBER. Are you making that request to them? Are you making that a strong suggestion to them?

Ms. LERNER. We suggested in our alert memo on large cooperative agreements that they do require incurred cost submissions and that they undertake incurred cost audits for those types of awards.

Mr. WEBER. And hopefully if they haven't had too much alcohol on the taxpayer dime they were able to read that and digest it. Okay.

Question for Ms. Bales, if a preconstruction cost proposal audit for a DOD project disclosed huge amounts of unsupported and/or questionable costs to that particular project, what happens to it?

Ms. BALES. We turn that information over to the contracting officer and they use that information through negotiations. If the proposal is grossly inadequate, they would probably go back to the contractor and ask them to fix the proposal and fix the inadequacies in it so it could be used to negotiate.

Mr. WEBER. To they come back to you all for approval for the changes they make or input—I guess I should say input by you all?

Ms. BALES. They, the contractor?

Mr. WEBER. Um-hum.

Ms. BALES. Yes, if they went back and redid their proposal——

Mr. WEBER. Um-hum.

Ms. BALES. —it would come back to us to audit again.

Mr. WEBER. Okay. And then you have the ability to say that looks better or it looks the same or worse?

Ms. BALES. Yes.

Mr. WEBER. Okay. All right. And, Ms. Lerner, in answer to your question, three strikes, I guess you could go to work for the IRS. But I will leave that alone.

Thank you all for being here.

Chairman SMITH. Thank you, Mr. Weber.

That concludes our questions. And let me thank both witnesses for their insightful answers, which are very much appreciated. And the responses that we got and your testimony today was both informative, enlightening, and sobering.

And, clearly, problems within the National Science Foundation have existed for many years. And let me say that the new director has only been in office for 8 months. I believe that she wants to correct these problems and I am hopeful that they will be corrected. But—including the problems that have been there for a long time, and as I say, I am hopeful of being able to work with the director and being able to address some of the deficiencies that you all have mentioned here today.

Thank you very much for your testimony and we will look forward to staying in touch.

[Whereupon, at 11:21 a.m., the Committee was adjourned.]

Appendix I

ANSWERS TO POST-HEARING QUESTIONS

ANSWERS TO POST-HEARING QUESTIONS

Responses by the Hon. Allison Lerner

HOUSE COMMITTEE ON SCIENCE, SPACE, AND TECHNOLOGY

"Review of the Results of Two Audits of the National Ecological Observatory Network"

Questions for the record, Ms. Allison Lerner, Inspector General, National Science Foundation

Questions submitted by Rep. Lamar Smith, Chairman, Committee on Science, Space, and Technology

1) In December of 2008, NEON requested a management fee from NSF that was not in their original contract proposal (see Attachment 1) for "unallowable" costs.
   a. What are "unallowable" costs and who at NSF should have seen this letter?

OIG Response

Unallowable costs are those that cannot be charged to an award because they: 1) are specifically identified in the award instrument as being unallowable; 2) are specifically identified in the applicable OMB Circular (in 2008, the applicable circular governing NEON was A-122)[1] as being unallowable; or 3) do not meet criteria listed in the circular as being allowable.

At a minimum, it would seem that NSF's Grants Officer should have seen the December 8, 2008 letter from NEON requesting management fee for certain uses. To obtain greater insight into how NSF negotiated and oversaw management fees, we have commissioned an in-depth audit of how management fees were managed and expended on particular awards, with an initial focus on two awardees, including NEON.

   b. Of the six unallowable items referenced in the letter, are any of them considered "ordinary and necessary" business expenses?

OIG Response

In absence of a clear definition it is difficult to state with precision which unallowable costs would be considered "ordinary and necessary" to maintain an institution's financial viability. Adding to this confusion, for example, is the fact that NEON does have "membership fees", which it seems could cover at least some of these expenditures.

As noted in OIG's white paper on management fees dated November 24, 2014, such fees have traditionally been used to cover "ordinary and necessary, but otherwise nonreimbursable, business expenses in order to maintain an entity's financial viability. (The document can be accessed on OIG's website at: http://www.nsf.gov/oig/reports/wp-mgmt-fees.pdf). However, as we point out in the paper, GAO has recognized a need for concrete guidance (with specific

[1] As of December 26, 2014, the various circulars have been replaced by the Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards, 2 CFR § 200.

examples) to define the boundaries of management fee use. In our view, a lack of clear definition can lead to confusion, misuse, and abuse.

Our management fee audit will examine NSF's (and NEON's) policies and procedures pertaining to management fee, as well as whether NEON's management fee use was necessary to facilitate that entity's basic operations and viability. We will share the results of that work with you.

2) NEON also stated in the letter (Attachment 1) that they:

> *"... signed a letter of intent with the Heinz Center, to lease a significant amount of office space for the NEON Washington, DC office. ... [then] NSF requested that NEON merge its Washington, DC office into a Boulder, Colorado office. While the letter of intent was not legally binding, NEON's Board of Directors determined that NEON had an ethical responsibility to reimburse the Heinz Center for incremental and otherwise, unreimbursed expenses."*

A. Under which accounting principles should an "ethical responsibility" be considered?

OIG Response

We are unaware of any cost principle in the former OMB Circulars or the current Uniform Guidance, 2 CFR § 200, that relates to expenses necessary to discharge an "ethical responsibility."

a. Is an alleged "ethical responsibility" a factor in determining whether something is an "ordinary and necessary" business expense?

OIG Response

It is hard for us to understand how "ethical responsibility" would factor into this business decision, especially since the letter of intent does not appear to be legally binding. As mentioned in the response to Question #1.b, OIG's management fee audit will examine NEON's management fee use. This will include considering whether relevant expenditures were necessary to facilitate the entity's basic operations and viability.

3) NEON further stated in the letter (Attachment 1) that it needed money for "Government Outreach Events," and clarified that "NEON anticipates the need to provide education to various governmental organizations as to NEON's mission, strategy and requirements."

a. Could "Government Outreach Events" also be described as lobbying expenses? If yes, what concerns do you have about the use of taxpayer funds for lobbying expenses?

OIG Response

It is possible that "government outreach events" could be described as lobbying expenses. We note that under the "Byrd Amendment," as amended by the Lobbying Disclosure Act of 1995, federal grantees, contractors, recipients of federal loans or those with cooperative agreements with the federal government, are prohibited by law from using federal monies to "lobby" the Congress, federal agencies or their employees with respect to the awarding of federal contracts, the making of any grants or loans, the entering into cooperative agreements, or the extension, modification or renewal of these types of awards.

OIG would always be concerned if it is determined that an awardee failed to comply with this restriction on the use of federal funds.

4) Based on your investigations, did you determine if NSF either explicitly or implicitly allowed NEON to use management fees to pay for lobbying, liquor and lavish Christmas parties throughout the duration of the project?

OIG Response

During the course of the DCAA audit, OIG learned that NEON had used its management fee award for the items noted. More information would be needed to understand whether or to what extent NSF "explicitly or implicitly" allowed this to happen. The audit we have commissioned will provide additional information pertaining to NSF's administration of the fee to NEON and that entity's actual use of the fee.

a. In audits conducted at other agencies, has DCAA ever identified the use of management fees for lobbying, liquor and lavish Christmas parties? Should management fees ever be allowed for such uses by non-profits?

OIG Response

We are not familiar with whether DCAA has surfaced management fee expenditures such as these in audits involving awards by other federal agencies. However, GAO has noted this in the past. (http://www.gao.gov/products/NSIAD-95-174; http://www.gao.gov/assets/230/222058.pdf)

It is hard to envision how NSF awardees could ever be justified in using management fee for "liquor and lavish Christmas parties." It is OIG's position that use of the fee for "lobbying" (as defined by the Byrd Amendment) is prohibited.

5) In a draft 2013 NEON audit, the then-principal auditor stated that NEON billed all of its "unallowable" costs to Grant "990-9," but noted that no such grant actually exists. He noted that all charges to Grant 990-9 are marked "unallowable" in NEON's records, and all charges to Grant 990-9 are drawn against NEON's management fee.
   a. What is the purpose of the Grant 990-9? By creating this award and permitting NEON to charge its "unallowable" expenses to it, has the NSF enabled NEON to circumvent otherwise "unallowable" costs?

OIG Response

During the course of the DCAA audit, we were informed about this procedural mechanism used to facilitate management fee payment. We also learned that NSF initially awarded management fee to NEON on a reimbursable basis, and the awardee used the fee to cover expenses that it had *already* incurred. Subsequent awards to NEON involved an upfront management fee percentage with a not-to-exceed amount.

As mentioned in our white paper, management fee has traditionally been used to cover "ordinary and necessary, but otherwise nonreimbursable (or unallowable), business expenses in order to maintain an entity's financial viability. Without adequate controls (e.g., upfront justification and monitoring) it is possible that the fee could be used for costs that are not consistent with this narrow purpose and which therefore circumvent guiding cost principles. The audit we have commissioned will further examine the applicable policies and procedures surrounding NEON's management fee awards.

We note that NSF's draft management fee policy takes steps to develop a control environment for such fees. (OIG's complete observations on the policy proposal are at: http://www.nsf.gov/oig/reports/Proposed%20Management%20Fee%20Policy.pdf)

6) In 2012, pursuant to a contract with the NSF OIG, DCAA rendered an adverse opinion on NEON's proposal audit.
    a. How many other contracts has your office engaged in with DCAA for which it has rendered adverse opinions on proposal audits of NSF-awarded grants? How has your office handled such revelations, and what has been the NSF response in those cases?

OIG Response: We commissioned audits for three proposals and NEON was the only one for which DCAA rendered an adverse opinion based on $154 million of questioned and unsupported costs. We note that DCAA issued a disclaimer of opinion on one proposal, for the Daniel K. Inouye Solar Telescope (DKIST). We have recommended that NSF obtain proposal audits for its high-risk, high-dollar cooperative agreements valued at $50 million and more, *prior* to making an award. OIG and NSF staff met multiple times to discuss our recommendations and NSF's proposed actions to strengthen accountability in response to the audits.

Despite that effort, the actions NSF proposed to address our recommendations fell short of the standard necessary to adequately safeguard federal funds and left millions of dollars at risk. Therefore, in May 2014, we escalated the recommendations to NSF's Audit Follow-up Official. We are evaluating NSF's January 2015 response to those recommendations and seeking clarification from NSF about the actions it proposed to take.

7. It appears that DCAA has performed or attempted to perform a number of audits of NSF's major research facility projects.

a. How many of those projects were either unable to be audited, or had some form of adverse audit?
b. Was NSF made aware of these audit problems? If so, what was NSF's response to rectify the problem?

OIG Response: DCAA performed or attempted to perform audits of the proposed budgets for three projects--Ocean Observatories Initiative (overseen by COL), the Daniel K. Inouye Solar Telescope, and NEON. As stated above, DCAA rendered an adverse opinion for NEON based on $154 million of questioned and unsupported costs.

After more than 17 months of audit activity, DCAA was able to audit COL's proposed budget and found that COL could not provide adequate documentation to support $88 million in proposed contingency costs.

The proposed budget for DKIST was twice found unacceptable for audit due to lack of support for costs including labor and indirect costs and for unallowable contingency. The project cost was re-baselined in 2012 and DCAA issued a disclaimer of audit opinion on the re-baselined proposal. As previously noted, an audit of NEON's proposed budget resulted in an adverse opinion.

As described above, we escalated recommendations stemming from this work to NSF and we remain concerned that NSF's proposed actions to address those recommendations will adequate safeguard the billions of taxpayer dollars invested in high-risk, high-dollar cooperative agreements for NSF's large facility projects.

8) In light of what we learned during the hearing about the NEON cooperative agreement, is this a situation that requires a legislative solution by Congress or is this a case that necessitates increased and persistent oversight of the NSF by this Committee?

OIG Response: While my office will continue to maintain stringent oversight, Congressional attention to NSF efforts to strengthen accountability would also be beneficial.

9) How comprehensive is NSF's auditing policy? For example, for major projects, does NSF require audits of the construction proposal, construction period, and construction completion? If not, should it?

OIG Response: Traditionally NSF has not required audits at any point during a construction project. Given the cost and risk associated with these projects, we have recommended that NSF require audits at the pre- and post-award stage for projects valued at $50 million or more.

In response to our recommendation to conduct proposal audits, NSF stated that it will obtain an "independent cost review" of proposed budgets. There is no assurance that these reviews will require the same rigor as an audit. When NSF's internal review of costs for the $467.7 million award for the LSST project, for example, identified serious problems and an audit was clearly warranted, NSF commissioned a contractor to perform a "sufficiency review", which is less rigorous than an audit. The review in question did not examine costs in sufficient detail to determine if problems identified in the initial review had been resolved prior to award of the cooperative agreement.

In addition, NSF does not require incurred cost submissions or incurred costs audits, which are necessary for proper cost monitoring because they provide visibility over awardees' claimed costs. Absent incurred cost submissions and audits, unallowable costs could be charged to awards and go undetected. In response to our recommendation to require annual incurred cost audits, NSF stated that it will require a final review of incurred costs at project *completion* for large facility construction projects valued at $100 million and more. Absent annual incurred cost audits, NSF may not be able to prevent misuse of funds or be able to recapture funds that it finds were misspent.

10) Typically, construction contingency costs are a way to account for the fluctuating prices of items such as lumber or structural steel – within predictable ranges – during a multi-year construction project. How does NSF determine and justify its construction contingency costs and what accounting principles does the Foundation follow?

OIG Response: NSF requires awardees to include contingency in proposed budgets to help ensure that there are no cost overruns. For each of the three projects audited, to determine construction contingency costs, NSF received a proposed budget which represented the proposing entity's base-cost estimate of what it would cost to achieve the project's goals. This base estimate applied escalation rates to all direct cost categories (such as equipment, materials, and labor) as selected and applied by the awardees. NSF then required the proposer to add amounts for contingencies. Escalation costs were then added to the contingency costs.

The DCAA staff that performed our audits (and their senior managers), indicated that while they regularly audit contingency in proposals, they have never seen a process for estimating contingencies like that used by NSF's awardees and sanctioned by NSF. Given the present lack of controls, there is virtually no accountability over the contingency funds, either at the expenditure phase or at the estimating phase.

NSF asserts that the way it determines and justifies construction contingency costs complies with OMB guidance.

11) For the NEON project, did NSF allow contractors to use contingency funds to modify the scope of the project? If so, does this absolve NSF from needing to review proposed changes in a project? If yes, is this practice permitted by federal cost principles, and has NSF approved similar actions in other major projects?

OIG Response: Because NSF did not require NEON to track and account for the use of budgeted contingency funds, there is a risk that contingency funds could have been used to modify the project scope, without NSF's approval. As the expenditure of contingency funds is not tracked in the awardee's accounting system, we cannot audit to determine how those amounts were expended. We thus cannot see if contingency funds were used appropriately; were used to add scope without NSF's approval; were used to hide cost overruns; or were used to make purchases that would otherwise be unallowable or inappropriate.

Through a change order process, NSF approves awardees' expenditure of contingency above a threshold amount ($150,000 for NEON); however, awardees can spend contingency funds below that threshold without NSF approval. NSF's contingency practices, which NSF has used in other large projects, are unique to NSF.

12) Your recently released semi-annual report to Congress includes adverse findings about two other multi-hundred-million dollar NSF projects, the Daniel K. Inouye Solar Telescope and the Large Synoptic Survey Telescope. Could you please summarize the problems and relate them to the NEON audits?

OIG Response: NSF approved proposed budgets for the Daniel K. Inouye Solar Telescope (DKIST) and the Large Synoptic Survey Telescope (LSST), and NEON totaling more than $1.1 billion although it lacked sufficient information to ensure that the budgets represented the basis for a fair and reasonable price. For example, the proposed budget for DIKST was twice found unacceptable for audit because of lack of support for labor costs and unallowable contingencies, among other things. After the proposed budget was re-baselined, a disclaimer of audit opinion was issued.

Similarly, the proposed budget for NEON contained $154 million in questioned and unsupported costs (such as costs for labor and unallowable contingency, and auditors issued three inadequacy memos because the proposal was not unacceptable for audit and finally issued an adverse opinion because the proposal did not form an acceptable basis for negotiation of a fair and reasonable price. NSF's own internal review of costs for LSST could not find support for *any* of the 136 transactions sampled—yet, NSF did not seek an independent audit of LSST's proposed budget.

The problems in the proposed budgets for DKIST, LSST, and NEON are the same—in each instance, NSF approved budgets for these multi-million dollar projects although it lacked sufficient information to ensure that budgets represented the basis for a fair and reasonable cost to the government.

Enclosure 1

neon

NATIONAL ECOLOGICAL OBSERVATORY NETWORK

Management Fee Request for NEON Award DBI-0752017

Beasley/Sheldon/Schimel
December 8, 2008

In May 2008 the National Science Foundation (NSF) awarded funding to the National Ecological Observatory Network, Inc. (NEON) for a project titled ***"Organizational & Project Management Support to complete the NEON Construction-Ready Design and Project Execution Plan"***, award DBI-0752017. The need for discretionary funds to cover potential expenses deemed to be "unallowable" under OMB A-122, was not addressed in late 2007 when the proposal for this award was drafted. Due to current restrictions placed upon NEON's only source of non-federal funds, membership dues, NEON has no source of funding for necessary or unavoidable "unallowable" expenditures. The purpose of this request to gain approval for a management fee that will provide NEON appropriate funds to handle such needs.

Approval is requested for a $190,000 management fee, payable in monthly installments. The proposed fee is covered within the total award budget. Utilization of the management fee is described below:

1. **Reimburse Membership Fees for Vender Conference Cancellation** $11,000

NEON previously requested, and received, permission to utilized membership fees to cover the cost of canceling a scheduled vender conference. However, NEON's membership fees are expected to cover the cost of membership meetings and events. It is our intent to restore these funds to the membership account.

2. **General Unallowable Cost – Meals, meetings** $14,000

Certain meals and meetings, while useful to furthering the overall NEON mission, are unallowable due to the lack of correlation to documented objectives under the current NEON / NSF Cooperative Agreements.

3. **Future Building & Site Study** $25,000

A well developed plan to optimize NEON's long-term headquarters (facility) plan is anticipated to be required during the timeframe of the current Cooperative Agreements. Such expenditure would be unallowable under the current CA's.

4. **Govt. Outreach Events** $30,000

NEON anticipates the need to provide education to various governmental organizations as to NEON's mission, strategy and requirements. Due to the difficulty of clear determination as to the allowability of specific expenditures, NEON would prefer to fund such events with monies that are not subject to OMB A-122.

I
n 2012, pursuant to a cont
ract with the NSF OIG, DCAA
rendered an ad

5. **Heinz Center – Lease Cancellation Expense** $50,000

NEON had signed a letter of intent with the Heinz Center, to lease a significant amount of office space for the NEON Washington, DC office. The Heinz Center, on the basis of the letter of intent, entered into an agreement to lease additional contiguous space, design and build out the space for NEON's occupancy. Subsequent to this event, the NSF requested that NEON merge it's Washington, DC office into a Boulder, Colorado office. While the letter of intent was not legally binding, NEON's Board of Directors determined that NEON had an ethical responsibility to reimburse the Heinz Center for incremental and otherwise, unreimbursed expenses.

6. **Risk Management – Losses, Termination Fees** $60,000

Despite good planning and contracting practices, there are occasions when the termination of contracts results in termination fees or expenditures that are considered to be unallowable. The primary causes of such terminations are:

a) Default – when a contractor cannot deliver the services or supplies as specified in the contract, or breaches any of the terms and conditions of the contract – it may be preferable to pay a relatively small termination fee rather than seek a legal remedy.
b) Convenience – when, as a result of changes in project needs, NEON no longer requires the services or supplies as contracted, a reasonable termination fee is frequently obligatory.

NEON is currently negotiating a termination fee with IISI. It is expected that the fee will be $12,000.

Summary

In order for NEON to efficiently and effectively pursue its mission, a source of funds that can be used with the discretion of NEON management for the purposes documented above, is necessary.

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neon
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NEON is currently negotiating a termination fee with IISI. It is expected that the fee will be $12,000.

Summary

In order for NEON to efficiently and effectively pursue its mission, a source of funds that can be used with the discretion of NEON management for the purposes documented above, is necessary.

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Responses by the Hon. Anita Bales

HOUSE COMMITTEE ON SCIENCE, SPACE, AND TECHNOLOGY

"Review of the Results of Two Audits of the National Ecological Observatory Network"

Questions for the record, Ms. Anita Bales, Director, Defense Contract Audit Agency

Questions submitted by Rep. Lamar Smith, Chairman, Committee on Science, Space, and Technology

1) In December of 2008, NEON requested a management fee from NSF that was not in their original contract proposal (see Attachment 1) for "unallowable" costs.
    a. Of the six unallowable items referenced in the letter, are any of them considered "ordinary and necessary" business expenses?

Answer: As context for DCAA's answer, the following is a brief description of the DCAA audit role and the audits we did for NSF on NEON:

DCAA's mission is to provide accounting and financial advisory services, in connection with the negotiation, administration and settlement of contracts and subcontracts, to all DoD procurement and contract administration activities. In addition to serving DoD, DCAA also furnishes contract audit service to other Government agencies. Importantly, DCAA's work for both DoD and civilian agencies focuses only on contractors and their financial assertions. Unlike the role of an Inspector General, DCAA does not review the actions of Government acquisition personnel but instead acts as advisors to those personnel based on our audit findings.

DCAA performed two audits for NSF IG: a proposal audit and an accounting system audit. In both these audits, we primarily worked with the NSF IG and did not audit or focus on the contract administration activities. In the proposal audit, we examined costs included in NEON's proposal. In the accounting system audit, we examined whether the system accurately accumulates and bills costs on Government awards. We did not, in either of these audits, audit the terms of the contract or their reasonableness because those issues are not in our purview.

Within the purview of our audit, we did not determine whether the six unallowable items referenced were considered "ordinary and necessary" because those items were paid for with the management fee and therefore not costs to be audited. Had they been auditable as costs, we would have considered them "ordinary and necessary" if they were:

- reasonable both in nature and cost
- incurred by a prudent person conducting business
- necessary for continued successful operations

2) NEON also stated in the letter (Attachment 1) that they:

> *"... signed a letter of intent with the Heinz Center, to lease a significant amount of office space for the NEON Washington, DC office. ... [then] NSF requested that NEON merge its Washington, DC office into a Boulder, Colorado office. While the letter of intent was not legally binding, NEON's Board of Directors determined that NEON had an ethical responsibility to reimburse the Heinz Center for incremental and otherwise, unreimbursed expenses."*

a. Under which accounting principles should an "ethical responsibility" be considered, and is an alleged "ethical responsibility" a factor in determining whether something is an "ordinary and necessary" business expense?

Answer: As context for DCAA's answer below, following is a brief description of the DCAA audit role and the audits we did for NSF on NEON:

DCAA's mission is to provide accounting and financial advisory services, in connection with the negotiation, administration and settlement of contracts and subcontracts, to all DoD procurement and contract administration activities. In addition to serving DoD, DCAA also furnishes contract audit service to other Government agencies. Importantly, DCAA's work for both DoD and civilian agencies focuses only on contractors and their financial assertions. Unlike the role of an Inspector General, DCAA does not review the actions of Government acquisition personnel but instead acts as advisors to those personnel based on our audit findings.

DCAA performed two audits for NSF IG: a proposal audit and an accounting system audit. In both these audits, we primarily worked with the NSF IG and did not audit or focus on the contract administration activities. In the proposal audit, we examined costs included in NEON's proposal. In the accounting system audit, we examined whether the system accurately accumulates and bills costs on Government awards. We did not, in either of these audits, audit the terms of the contract or their reasonableness because those issues are not in our purview.

Because we did not audit individual expenses covered by the fee, we cannot comment specifically on the Heinz Center lease. In general terms, an expense paid due to an "ethical responsibility," even if the expense was not a contractual requirement, might be considered as an ordinary and necessary business expense according to the three criteria in question 1 (i.e., reasonable both in nature and cost, incurred by a prudent person conducting business, and/or necessary for continued successful operations).

3) NEON further stated in the letter (Attachment 1) that it needed money for "Government Outreach Events," and clarified that "NEON anticipates the need to provide education to various governmental organizations as to NEON's mission, strategy and requirements."

a. Could "Government Outreach Events" also be described as lobbying expenses? If yes, what concerns do you have about the use of taxpayer funds for lobbying expenses?

Answer: As context for DCAA's answer below, following is a brief description of the DCAA audit role and the audits we did for NSF on NEON:

DCAA's mission is to provide accounting and financial advisory services, in connection with the negotiation, administration and settlement of contracts and subcontracts, to all DoD procurement and contract administration activities. In addition to serving DoD, DCAA also furnishes contract audit service to other Government agencies. Importantly, DCAA's work for both DoD and civilian agencies focuses only on contractors and their financial assertions. Unlike the role of an Inspector General, DCAA does not review the actions of Government acquisition personnel but instead acts as advisors to those personnel based on our audit findings.

DCAA performed two audits for NSF IG: a proposal audit and an accounting system audit. In both these audits, we primarily worked with the NSF IG and did not audit or focus on the contract administration activities. In the proposal audit, we examined costs included in NEON's proposal. In the accounting system audit, we examined whether the system accurately accumulates and bills costs on Government awards. We did not, in either of these audits, audit the terms of the contract or their reasonableness because those issues are not in our purview.

To determine if an event should be classified as lobbying, one would have to know the intent of that event. If it was found to be lobbying, we would then need to determine if the lobbying cost violates laws and regulations that govern how government funds may be spent. For example, if the events were reported as costs and classified as lobbying, they would be subject to the Byrd Anti-Lobbying Amendment, which prohibits appropriated funds from being used for that purpose. However, the Federal Register Vol. 55, No. 116, dated June 15, 1990, provides additional clarification. This guidance states that profit and fees under federal contracts, grants, loans, and cooperative agreements are not considered appropriated funds. Because a management fee is not considered appropriated funds, even an event classified as lobbying that was paid using that fee would not be in violation of the Byrd Amendment.

4) Based on your investigations, did you determine if NSF either explicitly or implicitly allowed NEON to use management fees to pay for lobbying, liquor and lavish Christmas parties throughout the duration of the project?
   a. In audits conducted at other agencies, has DCAA ever identified the use of management fees for lobbying, liquor and lavish Christmas parties? Should management fees ever be allowed for such uses by non-profits?

Answer: As context for DCAA's answer below, following is a brief description of the DCAA audit role and the audits we did for NSF on NEON:

DCAA's mission is to provide accounting and financial advisory services, in connection with the negotiation, administration and settlement of contracts and subcontracts, to all DoD procurement and contract administration activities. In addition to serving DoD, DCAA also furnishes contract audit service to other Government agencies. Importantly, DCAA's work for both DoD and civilian agencies focuses only on contractors and their financial assertions. Unlike the role of an Inspector General, DCAA does not review the actions of Government acquisition personnel but instead acts as advisors to those personnel based on our audit findings.

DCAA performed two audits for NSF IG: a proposal audit and an accounting system audit. In both these audits, we primarily worked with the NSF IG and did not audit or focus on the contract administration activities. In the proposal audit, we examined costs included in NEON's proposal. In the accounting system audit, we examined whether the system accurately accumulates and bills costs on Government awards. We did not, in either of these audits, audit the terms of the contract or their reasonableness because those issues are not in our purview.

Because we audited the contractor and not NSF management, it was not in the purview of our audit to determine whether NSF either explicitly or implicitly allowed NEON to use management fees to pay for the expenses you have identified. By regulation, management fees are not auditable as costs that would otherwise be unallowable under FAR. However, at the request of NSF IG, we did provide a memorandum entitled, "Observations that Warrant Attention of the NSF-OIG," dated October 6, 2014. In the memorandum, we make two recommendations to the NSF IG for actions NSF could take to exercise greater oversight on management fees:

(1) Require NSF to strengthen the NSF grant policy to specify requirements for determining and monitoring the award of fee.
(2) Benchmark with other Federal agencies to determine their use of management fee and how other agencies allow the use of that fee in audits conducted at other agencies.

In audits with other non-profit organizations, we have identified fee as a part of cooperative agreements. However, we do not have comprehensive, consolidated information on all of those audits. To answer this question, we looked at a sample of seven different organizations from one of our regions. All seven had grants or agreements in which they earned a fee. In those audits, we did not audit expenses covered by fee because our audits only cover cost reimbursements and fee is not considered cost. Even though these expenses were not audited, the submissions did show expenses that would have been unallowable if they were reported as costs rather than paid for with the management fee. For example, some expenses included alcohol as part of travel or entertainment expenses, and one organization did have a general ledger account labeled "lobbying." But again, we did not audit these expenses, so we cannot attest to what was actually paid for with the fee.

5) It appears that DCAA has performed or attempted to perform a number of audits of NSF's major research facility projects.

a. How many of those projects were either unable to be audited, or had some form of adverse audit?
b. Was NSF made aware of these audit problems? If so, what was NSF's response to rectify the problem?

Answer: As context for DCAA's answer below, following is a brief description of the DCAA audit role and the audits we did for NSF on NEON:

DCAA's mission is to provide accounting and financial advisory services, in connection with the negotiation, administration and settlement of contracts and subcontracts, to all DoD procurement and contract administration activities. In addition to serving DoD, DCAA also furnishes contract audit service to other Government agencies. Importantly, DCAA's work for both DoD and civilian agencies focuses only on contractors and their financial assertions. Unlike the role of an Inspector General, DCAA does not review the actions of Government acquisition personnel but instead acts as advisors to those personnel based on our audit findings.

DCAA performed two audits for NSF IG: a proposal audit and an accounting system audit. In both these audits, we primarily worked with the NSF IG and did not audit or focus on the contract administration activities. In the proposal audit, we examined costs included in NEON's proposal. In the accounting system audit, we examined whether the system accurately accumulates and bills costs on Government awards. We did not, in either of these audits, audit the terms of the contract or their reasonableness because those issues are not in our purview.

From FY10 to present we issued 85 reports or memos to either NSF management or NSF IG that fall into four major categories: forward pricing, incurred cost, system audits, and other. We issued 27 unqualified reports, which indicated that we had no material findings; 23 qualified reports, which indicated that we questioned some costs or had some other type of finding; 5 adverse reports, which indicated that there were significant misstatements; and 2 disclaimers, which indicated that we were unable to gain sufficient information to form an opinion. Of those 85 reports, 9 were on systems—3 of which were in compliance with requirements and 6 of which contained some non-compliances. The remaining memos were on types of engagements for which we do not issue an opinion. When NSF management was the requestor for the work, we directly informed NSF management of our results by issuing the report to them. If NSF IG was the requestor, we issued the report to NSF IG and presumed that they passed the results on to management. Our records indicate that during this time, NSF sustained about 40 percent of costs we questioned; however, we do not know all the actions NSF took in response to our reports.

6) In light of what we learned during the hearing about the NEON cooperative agreement, is this a situation that requires a legislative solution by Congress or is this a case that necessitates increased and persistent oversight of the NSF by this Committee?

Answer: As context for DCAA's answer below, following is a brief description of the DCAA audit role and the audits we did for NSF on NEON:

> DCAA's mission is to provide accounting and financial advisory services, in connection with the negotiation, administration and settlement of contracts and subcontracts, to all DoD procurement and contract administration activities. In addition to serving DoD, DCAA also furnishes contract audit service to other Government agencies. Importantly, DCAA's work for both DoD and civilian agencies focuses only on contractors and their financial assertions. Unlike the role of an Inspector General, DCAA does not review the actions of Government acquisition personnel but instead acts as advisors to those personnel based on our audit findings.
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We audited to the terms of the cooperative agreement, A-122, Cost Principles for Non-Profit Organizations, and A-110, Uniform Administrative Requirements for Grants and Agreements with Institutions of Higher Education, Hospitals, and Other Non-Profit Organizations. Per those regulations, a management fee is allowable to pay for expenses that are normally unallowable as costs under the cooperative agreement. As we recommended to the NSF IG, however, the NSF should strengthen its grant policy for determining and monitoring the award of fee, and it should benchmark the use of management fees against its use by other Federal agencies

7) What is the standard auditing procedure for DOD projects with dollar values similar to NEON, and how do the DOD and NSF auditing procedures differ? For example, do DOD and NSF require annual audits of large ongoing projects and does either agency require final audit costs at the conclusion of major projects?

Answer: As context for DCAA's answer below, following is a brief description of the DCAA audit role and the audits we did for NSF on NEON:

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Under FAR, if a DoD contractor was awarded a cost reimbursable contract the size of the NEON cooperative agreement, DCAA would typically conduct an annual audit of its incurred costs for allowability, allocability, and reasonableness before contract closeout. Additionally, if the contractor was sole source, or the value of the cost reimbursable contract was over $100 million, we would likely conduct a forward pricing proposal audit as well. We are not sure if NSF requires annual audits of large, ongoing projects or final audit costs at the conclusion of major projects. Over the years, we have received requests from the NSF IG and NSF management to do different types of audits for both profit and not for profit contractors and cooperative agreements. We are not sure of the factors or procedures they use to request our audit services.

8) How comprehensive is NSF's auditing policy? For example, for major projects, does NSF require audits of the construction proposal, construction period, and construction completion? If not, should it?

Answer: As context for DCAA's answer below, following is a brief description of the DCAA audit role and the audits we did for NSF on NEON:

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As stated in question 7, we've done different types of audits based on requests from both NSF management and NSF IG, but we are not aware of the criteria or auditing policy they use to request our services.

9) Typically, construction contingency costs are a way to account for the fluctuating prices of items such as lumber or structural steel – within predictable ranges – during a multi-year construction project. How does NSF determine and justify its construction contingency costs and what accounting principles does the Foundation follow?

Answer: As context for DCAA's answer below, following is a brief description of the DCAA audit role and the audits we did for NSF on NEON:

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In our audits, we did not review how NSF determines or justifies its construction contingency costs. However, it does appear from our review of the NEON's accounting records that NSF was following the intent of 48 CFR 9905.501-40(c), which "allow[s] for the grouping of homogenous costs in estimates and for the accumulation and reporting of such costs in greater detail." This cost accounting standard considers the grouping of homogenous costs acceptable when it is not practical to estimate contract costs by individual cost elements (48 CFR 9905.501-50(a)). Because the nature of the costs varies to cover unexpected technical problems and uncertainties in completing the scope of the work, it might not be practical for a not-for-profit entity to estimate the uncertainties at an individual cost element level. However, when a not-for-profit entity actually incurs costs, all costs (including any additional costs that come from the contingency) are booked in the accounting records by the nature of the costs.

10) For the NEON project, did NSF allow contractors to use contingency funds to modify the scope of the project? If so, does this absolve NSF from needing to review proposed changes in a project? If yes, is this practice permitted by federal cost principles, and has NSF approved similar actions in other major projects?

Answer: As context for DCAA's answer below, following is a brief description of the DCAA audit role and the audits we did for NSF on NEON:

DCAA's mission is to provide accounting and financial advisory services, in connection with the negotiation, administration and settlement of contracts and subcontracts, to all DoD procurement and contract administration activities. In addition to serving DoD, DCAA also furnishes contract audit service to other Government agencies. Importantly, DCAA's work for both DoD and civilian agencies focuses only on contractors and their financial assertions. Unlike the role of an Inspector General, DCAA does not review the actions of Government acquisition personnel but instead acts as advisors to those personnel based on our audit findings.

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During our audit, we did not have the scientific, technical expertise to determine if contingency funds were used for scope changes. To help in our assessment, we requested a technical evaluation from NSF OIG to determine whether NEON's expenditures were, in fact, changes in scope in the project. We did not receive the technical evaluation, which prevented us from completing the necessary audit procedures to ensure proper use of contingency funds. Nonetheless, we did issue a memorandum to the NSF-IG with recommendations to strengthen controls over contingency funds. Specifically, we recommended that, as a condition of award, awardees track the proposed use of the contingency cost in the budget control log and provide fully supported bases of estimates for contingencies. If NSF was to take these actions, it should provide them with better oversight of how the contingency funds are used.

Using contingency funds for scope changes does not alter the need for NSF to review proposed changes. In addition, regulations do not stipulate if contingency funds can be used for scope changes; this is the Contracting/Grant Officer's determination. For FAR contracts, scope changes are governed by FAR Part 43 and implemented according to specific contract clause. In the case of the NEON cooperative agreement, the contract stipulated that all scope changes required the approval of the NSF Program Manager. On other NSF projects, we have seen contingency funds cover increases in scope. For example, in an incurred cost audit of the University of Wisconsin-Madison, contingency funds were used to increase the scope of the project after coordination with the NSF Program Office.

11) It appears that the NSF considers several factors when determining whether a management fee is warranted in certain grants to nonprofits. Did the DCAA audit of NEON find documentation to demonstrate the process NSF went through prior to approving management fees for NEON? And if so, what was the documentation?

Answer: As context for DCAA's answer below, following is a brief description of the DCAA audit role and the audits we did for NSF on NEON:

DCAA's mission is to provide accounting and financial advisory services, in connection with the negotiation, administration and settlement of contracts and subcontracts, to all DoD procurement and contract administration activities. In addition to serving DoD, DCAA also furnishes contract audit service to other Government agencies. Importantly, DCAA's work for both DoD and civilian agencies focuses only on contractors and their financial assertions. Unlike the role of an Inspector General, DCAA does not review the actions of Government acquisition personnel but instead acts as advisors to those personnel based on our audit findings.

DCAA performed two audits for NSF IG: a proposal audit and an accounting system audit. In both these audits, we primarily worked with the NSF IG and did not audit or focus on the contract administration activities. In the proposal audit, we examined costs included in NEON's proposal. In the accounting system audit, we examined whether the system accurately accumulates and bills costs on Government awards. We did not, in either of these audits, audit the terms of the contract or their reasonableness because those issues are not in our purview.

We did not audit NSF processes on how they approved management fees on either our proposal audit or our accounting system audit. We did obtain limited documentation in the form of a spreadsheet, which showed a listing of expenditures that NEON paid for using management fees. However, this document did not provide information on NSF's process for approval.

12) It is our understanding that DCAA has recently established an independent DCAA Office of Inspector General (OIG). While we applaud the creation of the office, we have some questions about the selection of Ms. Angela Janysek-Denzler, the former DCAA Assistant Director, as the first DCAA IG. Specifically, given Ms. Janysek-Denzler's presumed close relationship with current members of DCAA's senior staff, including yourself, how may Congress be assured of Ms. Janysek-Denzler's independence, particularly in cases involving complaints brought against her senior-level former co-workers?

    a. Further, Mr. J. Kirk McGill, a DCAA employee who has sought whistleblower status, has filed complaints against the DCAA, some of which have been directed toward Ms. Janysek-Denzler in her former role as DCAA Assistant Director. Will such complaints convert to the OIG? If so, what will be Ms. Janysek-Denzler's level of involvement, and what mechanisms does the DCAA OIG have to ensure any conflict of interest concerns are adequately and transparently addressed?

Answer: Pursuant to Department of Defense Directive (DoDD) 5106.04, the DCAA Director appointed Ms. Janysek-Denzler to the position of DCAA Inspector General (IG), effective January 5, 2015. Ms. Janysek-Denzler previously served as the head of the Agency's Internal Review Directorate (IRD), an independent organization within the Agency that, similar to an IG Office (OIG), served to investigate complaints related to the Agency's mission. DODD 5106.04 applies to all non-statutory IGs within the Department of Defense; it requires all IGs to be fair and impartial in furtherance of the effective and fair management and operation of DoD entities. Ms. Janysek-Denzler has demonstrated her ability to be fair and impartial, and to adhere to law, rule and regulation, since her appointment in the Federal Service approximately two and a half years ago. Prior to her appointment with DCAA, she had served approximately 22 years as a Senior Commissioned Warrant Officer with the United States Army, during which time she fairly and responsibly investigated allegations of felony-level crimes.

Congress may be assured of Ms. Janysek-Denzler's independence with respect to complaints involving senior-level DCAA officials because, in accordance with DoDD 5505.06, such complaints are reported to the Office of the Inspector General for the Department of Defense (OIG DoD). The OIG DoD was established by Congress as an independent, objective unit within DoD to conduct and supervise audits, investigations, evaluations, and inspections relating to DoD programs. Allegations of misconduct against senior officials will be vigorously investigated by appropriate investigative organizations.

All allegations previously within the purview of IRD now fall under the jurisdiction of DCAA's OIG and will be processed in accordance with applicable law, rule, and regulation. In the event a complaint presents a conflict of interest for the DCAA IG, the DCAA IG will transfer the complaint to OIG DoD in accordance with OIG DoD guidance.

Enclosure 1

NATIONAL ECOLOGICAL OBSERVATORY NETWORK

Management Fee Request for NEON Award DBI-0752017

Beasley/Sheldon/Schimel
December 8, 2008

In May 2008 the National Science Foundation (NSF) awarded funding to the National Ecological Observatory Network, Inc. (NEON) for a project titled ***"Organizational & Project Management Support to complete the NEON Construction-Ready Design and Project Execution Plan"***, award DBI-0752017. The need for discretionary funds to cover potential expenses deemed to be "unallowable" under OMB A-122, was not addressed in late 2007 when the proposal for this award was drafted. Due to current restrictions placed upon NEON's only source of non-federal funds, membership dues, NEON has no source of funding for necessary or unavoidable "unallowable" expenditures. The purpose of this request to gain approval for a management fee that will provide NEON appropriate funds to handle such needs.

Approval is requested for a $190,000 management fee, payable in monthly installments. The proposed fee is covered within the total award budget. Utilization of the management fee is described below:

1. **Reimburse Membership Fees for Vender Conference Cancellation** $11,000

NEON previously requested, and received, permission to utilized membership fees to cover the cost of canceling a scheduled vender conference. However, NEON's membership fees are expected to cover the cost of membership meetings and events. It is our intent to restore these funds to the membership account.

2. **General Unallowable Cost – Meals, meetings** $14,000

Certain meals and meetings, while useful to furthering the overall NEON mission, are unallowable due to the lack of correlation to documented objectives under the current NEON / NSF Cooperative Agreements.

3. **Future Building & Site Study** $25,000

A well developed plan to optimize NEON's long-term headquarters (facility) plan is anticipated to be required during the timeframe of the current Cooperative Agreements. Such expenditure would be unallowable under the current CA's.

4. **Govt. Outreach Events** $30,000

NEON anticipates the need to provide education to various governmental organizations as to NEON's mission, strategy and requirements. Due to the difficulty of clear determination as to the allowability of specific expenditures, NEON would prefer to fund such events with monies that are not subject to OMB A-122.

5. **Heinz Center – Lease Cancellation Expense** **$50,000**

NEON had signed a letter of intent with the Heinz Center, to lease a significant amount of office space for the NEON Washington, DC office. The Heinz Center, on the basis of the letter of intent, entered into an agreement to lease additional contiguous space, design and build out the space for NEON's occupancy. Subsequent to this event, the NSF requested that NEON merge it's Washington, DC office into a Boulder, Colorado office. While the letter of intent was not legally binding, NEON's Board of Directors determined that NEON had an ethical responsibility to reimburse the Heinz Center for incremental and otherwise, unreimbursed expenses.

6. **Risk Management – Losses, Termination Fees** **$60,000**

Despite good planning and contracting practices, there are occasions when the termination of contracts results in termination fees or expenditures that are considered to be unallowable. The primary causes of such terminations are:

a) Default – when a contractor cannot deliver the services or supplies as specified in the contract, or breaches any of the terms and conditions of the contract – it may be preferable to pay a relatively small termination fee rather than seek a legal remedy.
b) Convenience – when, as a result of changes in project needs, NEON no longer requires the services or supplies as contracted, a reasonable termination fee is frequently obligatory.

NEON is currently negotiating a termination fee with IISI. It is expected that the fee will be $12,000.

Summary

In order for NEON to efficiently and effectively pursue its mission, a source of funds that can be used with the discretion of NEON management for the purposes documented above, is necessary.

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Appendix II

Additional Material for the Record

MEMORANDUM SUBMITTED BY RANKING MEMBER EDDIE BERNICE JOHNSON

National Science Foundation
4201 Wilson Boulevard, Arlington, Virginia 22230

MEMORANDUM:

Date:	February 27th, 2013
From:	Ms. Martha A. Rubenstein Marty Office Head and Chief Financial Officer, Office of Budget, Finance, and Award Management
To:	Dr. Brett M. Baker Assistant Inspector General for Audit Office of Inspector General
Subject:	Response to "NSF OIG Alert Memo, Report No. 12-6-001, Dated September 28, 2012, NSF's Management of Cooperative Agreements"

This Memorandum provides our organization's response to the subject Alert Memo, which addresses OIG concerns specific to NSF's cost surveillance measures for awarding and managing cooperative agreements. In issuing the Alert Memo, the OIG has requested that NSF provide a corrective action plan addressing the recommendations contained in the document by no later than April 1st, 2013. This Memorandum is being forwarded prior to that date in order to provide an advance summary of BFA's position on this matter, and to facilitate ongoing dialogue between our offices to resolve issues identified in the Alert Memo.

On December 4th, 2012, the NSF Director announced the beginning of a four month internal review of all aspects of this agency's support for large research facilities. The review will result in recommendations, which if implemented, may alter the manner in which NSF prioritizes, builds, and operates large research facilities. Therefore, this response to the subject OIG Alert Memo reflects current NSF procedures and practices as well as planned improvements that have been previously identified to your office. If additional improvements are identified based on completion of the four month internal review, BFA will strongly support their implementation. Further, while noting that differences may exist between BFA and the OIG on the specific methodologies that will best achieve the vigorous oversight of large facility projects sought by both our organizations, we emphasize that BFA is in full agreement with the OIG's stated emphasis within the Alert Memo that it is imperative that the agency exercise strong cost surveillance controls over the lifecycle of large facilities projects.

Prior to final issuance, a draft of the Alert Memo was forwarded to NSF for comment, and we appreciate that comments provided by our office were considered in the preparation of the final document. We also continue to stress areas of agreement between our organizations associated with the development and implementation of strengthened procedures for reviewing large facility project cost estimates prior to construction, and for post-award monitoring of incurred costs during project execution. Through separate correspondence, we have provided information on specific actions that are being initiated in both the pre-award and post-award budget and cost review process to strengthen business controls already utilized by the agency, including additional internal analysis of awardee proposal budget and financial systems information, increased use of outside cost analysis and audit support to augment budget estimate reviews, and the utilization of incurred cost audits, when appropriate, to strengthen the review of billed costs. BFA is committed to implementing these process updates on an aggressive schedule in order to enhance current procedures to ensure proper oversight of large facility construction costs.

While emphasizing our common goals to ensure vigorous oversight of large facility projects, and while remaining strongly committed to working with the OIG to resolve differences in how those goals are best achieved, we are concerned with many of the specific assertions raised by the OIG in the Alert Memo. These assertions question the validity of the procedures currently used by the agency to manage large facility projects, and conclude that many NSF projects include costs that are "unsupportable," and "unallowable," "undermining the agency's ability to serve as a proper steward of federal funds." BFA strongly disagrees with these conclusions. Our positions on these matters have been consistently related to your office through our prior response to the draft Alert Memo, and through other official communications that have been provided consistently and through multiple venues, including through the agency's Annual Financial Statement Audit review. We are especially concerned that conclusions have been drawn in the Alert Memo prior to final disposition of audit reports cited in the document, and that recommendations have been made advocating mandatory conduct of pre and post award audits not based on the specific circumstances of individual projects, but as a requirement for all large facility cooperative agreement awards.

Based on the foregoing, BFA takes this opportunity to address statements and conclusions contained within the Alert Memo where disagreements exist between our organizations, or where we do not consider conclusions made to be accurately framed within the context of regulatory requirements applicable to federal financial assistance programs. The following represent a summary of BFA's major concerns with the assertions made in the Alert Memo.

- The OIG advocates requiring pre-award cost proposal audits for all major facility awards exceeding $50M in value. BFA believes that audits should only be required when analysis concludes that audits, which can be costly and time consuming, are warranted, and would be superior to other cost analysis information available to the Grants Officer. In fact, the OIG advocates standards for obtaining audits that exceed those imposed for federal contract awards. DCAA's own internal policies indicate that a threshold of $100M has been established for *consideration* of conducting audits for cost reimbursement instruments, and emphasizes the requirement that it is the requesting organization that is responsible for determining the extent of field pricing support required, including establishment of specific areas for which audit input is needed.
- The OIG also advocates pre-award accounting system audits for all major facility awards exceeding $50M. Again, BFA believes that audits should only be obtained when determined necessary by the Grants Officer, especially in that federal policy states that annual A-133 audits are to be used in lieu of other audits except when they do not meet the Agency's needs. For determining accounting system adequacy, BFA has procedures in place consistent with those of other Federal Agencies to make these determinations pre-award, and to monitor system compliance post award. Accounting system audits should be obtained only when necessary, and

in consideration of other information available to the Grants Officer, such as the record of fiduciary responsibility already available for the institutions managing these awards.

- OIG concerns raised in the Alert Memo are largely based on what are characterized as "dramatic" findings of approximately $305 million (almost 28 percent of estimated costs) in unallowable or unsupported costs associated with three recently commissioned DCAA audits. However, the assertion of these costs being "unallowable" and "unsupportable" are made by the OIG prior to resolution of the audit reports, and to any unresolved matters being addressed through the proper resolution process (OMB Circular A-50 Audit Followup). It is also important to clarify that these audits are associated with establishing the up-front cost <u>estimates</u> for the awards in question, and do not represent audits of costs already <u>incurred</u> by awardees.
- Much of the OIG's contention concerning the inclusion of unallowable and unsupportable costs in large facility proposals centers on the fact that NSF uses contingency estimates to better define anticipated project costs. Both the OIG and the DCAA consider these estimates to be prohibited from inclusion in the cost estimates established in the cooperative agreements for these projects. However, the OMB has recently published planned federal-wide guidance reaffirming the NSF position that these estimates may be included within the estimated cost for large construction awards. These estimates represent the majority of the costs questioned in the audits.
- The Alert Memo criticizes awardee institutions (non-profit and educational organizations) audited as not providing timely and supportable data in response to DCAA audit requests. While the OIG asserts that these circumstances show a lack of diligence on the part of awardees and an inability to support costs, BFA believes that problems and delays have been driven instead by the OIG and DCAA retroactively requiring audit detail not originally required from these organizations, inconsistent with the information that had been required by NSF prior to award of the agreements.
- The OIG questions the processes used by NSF to track contingency estimates during project execution. However, the OIG position conflicts with widely held Government and industry standard practices for properly managing contingency estimates. Consistent with these practices, BFA continues to stress that contingency estimates are managed at an aggregate versus at an individual cost element level, are properly assigned to appropriate cost categories when the budget estimate has matured, and are subject to payment by NSF only when determined to be allowable under the appropriate OMB cost principles.
- The Alert Memo states that cooperative agreement awards for large facility projects should be subject to annual incurred cost audits. While BFA agrees that strong cost surveillance procedures are required, we disagree with a mandate for annual incurred cost audits for all awards exceeding $50M in value. Instead, BFA advocates post award review of incurred costs building on pre-established federal post-award audit requirements, and addressing the need for additional reviews based on award risk. We believe this position to be consistent with regulatory requirements governing such audits. BFA has previously disclosed to the OIG an initiative to commission the use of incurred cost audits for major large facility cooperative agreements, when necessary, and following an agency risk analysis to determine the level of post-award audit review appropriate.
- Finally, the Alert Memo indirectly criticizes NSF's use of cooperative agreements for executing large facility projects, stating that use of these types of instruments is discretionary by the agency, and that these awards do not provide the same level of transparency over transactions and are not subject to the same rigors and reporting mechanisms as contracts. BFA disagrees

with this assessment. First, we consider the use of cooperative agreements for these awards to be the appropriate choice of award vehicle based on statutory language in the Federal Grant and Cooperative Agreement Act. Second, NSF has the authority to implement procedures to ensure proper transparency and rigor in execution of the awards.

A detailed analysis of the Alert Memo has been developed by BFA staff and is provided as an attachment to this document. Matters raised in the Alert Memo that are addressed in the attachment center on: (1) federal requirements for obtaining pre-award proposal and accounting system audits, (2) the specific findings of the Defense Contract Audit Agency (DCAA) resulting from their audits of three in-process agency construction awards cited in the Memo, (3) requirements for obtaining audits of awardee post-award incurred cost submissions, (4) use of Standard Form 424 or an equivalent process to segregate allowable and unallowable costs and to provide greater visibility, (5) proper accounting of project contingency funds and the separate tracking of budgeted versus actual contingency costs, and (6) choice of award instrument. We note that while addressing our disagreements with the OIG concerning statements made in the Alert Memo, we again take the opportunity within the attached responses to also highlight areas of agreement and planned process improvements to address concerns raised by your Office.

Attachment

Attachment – BFA Analysis of OIG Alert Memo Report No. 12-6-001, Dated September 28, 2012, NSF's Management of Cooperative Agreements"

Requirements for Obtaining Pre-Award Proposal and Accounting System Audits

The Alert Memo states that during the pre-award phase of a large facility project, cost monitoring procedures should include the conduct of audits of an awardee's proposed budget and accounting systems to ensure that cost estimates are fair and reasonable, and that the awardee's accounting system is adequate to bill the government properly. BFA is in full agreement with these goals. However, we disagree with the proposed emphatic requirement that pre-award Defense Contract Audit Agency (DCAA) audits are necessary pre-requisites to making these determinations *in all cases* for awards of \$50M or greater. We also disagree with the statement contained within the Alert Memo that "without proposal audits, NSF is left making funding decisions without adequate information to confirm the reasonableness of the estimates." OMB Circular A-110 "Uniform Administrative Requirements for Grants and Agreements with Institutions of Higher Education, Hospitals, and Other Non-Profit Organizations," contains no mandatory requirements or thresholds for the conduct of pre-award audits of cost proposals for financial assistance awards, and the OIG has acknowledged that there is no federal requirement for the conduct of such audits. Instead, federal policy delegates authority to individual federal agencies to establish procedures for determining the cost reasonableness of financial assistance instruments prior to award. We note that as previously related to the OIG, BFA is reviewing established agency policy for performing pre-award cost proposal reviews of major facility awards, and has determined areas where these procedures can be strengthened. These updated procedures will ensure that it is explicitly clear that situations may exist where obtaining a pre-award audit for all, or parts of a proposal, may be necessary. However, BFA disagrees with the establishment of mandatory audit thresholds. First, we note that the OIG advocated policy is inconsistent with policies set forth at other federal agencies for the review of financial assistance awards. Further, for the purpose of comparative benchmarking, the proposed policy is also inconsistent with federal requirements for pre-award audit of planned contract awards. Federal Acquisition Regulation requirements state that pre-award field pricing support provided for the purpose of determining cost reasonableness should reflect the minimum essential supplementary information needed to conduct a technical or cost or pricing analysis. In fact, a review of the DCAA Contract Audit Manual indicates that a threshold of \$100M has been established by that agency for *consideration* of conducting audits for cost reimbursement instruments, and re-emphasizes the requirement that it is the contracting officer who is responsible for determining the extent of field pricing support required, including establishment of specific areas for which audit input is needed (reference DCAA Contract Audit Manual, Sec. 9-102.1.b.). We further note that even in circumstances exceeding this threshold, DCAA's own internal procedures state that the level of audit support necessary is to be determined in collaboration with the requesting office, and that prior to initiation of an audit the level of risk associated with the proposal should be discussed with the requesting office, and alternatives to full audit of proposals considered when warranted.

For federal financial assistance awards, it is the responsibility of the warranted Grants Officer to determine if outside independent audit activity is necessary to adequately evaluate proposed costs. At NSF, requests for full audit of proposals must be considered in the context of other available methods for determining cost reasonableness. For example, NSF may determine that full pre-award audits are unnecessary for certain proposals submitted by organizations with pre-established and agreed to rate structures that have been previously reviewed by the Government, and for which a full review of technical content can be conducted by both independent outside panels and by internal technical experts. We are also concerned that proposal audit is a time consuming process that could lengthen the project development period, and therefore requests for such audits should not be mandated prior to evaluating other available cost analysis techniques that may be equally effective for determining cost reasonableness. Examples of such techniques include comparison of cost elements proposed to historical cost information, available audit information, wage and salary surveys, catalog prices, price indices, and independent cost estimates; non-advocate review; and reasonableness reviews by staff and paid technical experts. Although the Alert Memo criticizes NSF's long established practice of utilizing independent outside panel reviews of technical experts to support cost analysis of large facility construction proposals, BFA considers this approach to be superior to analysis available from audit organizations without direct knowledge of complex systems and construction requirements associated with such projects and is recognized by respected authorities as a legitimate assessment technique (e.g., see the GAO Cost Estimating and Assessment Guide, p. 188). As acknowledged by the OIG, these evaluations are supplemented by analysis performed by the cognizant NSF Grants Officer. BFA is also working to strengthen procedures for obtaining additional cost analysis reviews of proposal information by the agency's Cost Analysis and Audit Resolution Branch.

Based on the foregoing, we believe that to require pre-award audits of large facility construction proposals in all circumstances when the estimated project value exceeds $50M is inconsistent with established federal policy, and with the cognizant Grants Officer's responsibility to determine on a case-by-case basis the level of analysis necessary to determine cost reasonableness.

Regarding cost accounting system review, we note that NSF does perform pre-award desk reviews of new awardee organizations. These reviews focus on prospective new awardees' accounting systems, policies and procedures, and facilitate determining the suitability and financial viability of potential awardees. If an organization's financial systems are determined to be incomplete or inadequate, recommendations that funding be either postponed or not provided to the organization are made. We note that similar to requirements for pre-award cost proposal reviews, financial assistance policy does not mandate pre-award DCAA audit of an awardee's accounting system as a prerequisite to the award of individual grant or cooperative agreement actions.

Additionally, for organizations that have a history of financial assistance awards with NSF, known information is checked to determine whether any findings exist that adversely affect the agency's conclusion about the adequacy of the recipient's accounting system. For new awardees, BFA is working to strengthen procedures for the review of accounting systems by fully adopting procedures set forth in NSF policy, including the NSF Proposal and Award Manual (PAM) and the NSF Prospective New Awardee Guide. As set forth in the PAM, NSF requires that prospective new awardees submit information that will allow the agency to evaluate the administrative and financial systems in place at the awardee's organization. Information on specific documentation requirements is set forth in the NSF Prospective New Awardee Guide. Per the requirements of the Guide, organizations receiving awards are required to have an adequate accounting system in order to provide assurances to the Federal Government that the awardee can support the requirement that expenditures of federal funds are in accordance with applicable regulations and with the terms and conditions of the award. It is also noted that procedures set forth in the Guide specifically state that the fact that an organization may already have an active award does not preclude NSF from asking the organization to submit more detailed information to support the government's evaluation, and that the amount of risk involved in the award determines the depth to which NSF examines a proposer's capability to execute a Federal award and whether appropriate terms and conditions apply to the award to protect the interests of the Government.

In sum, while agreeing that a pre-award accounting system audit may be a viable tool available to the Grants Officer for determining accounting system adequacy, we must disagree with a mandate that such audits be a prerequisite for any award $50M or greater. Instead, such audits should only be initiated when information available to the Grants Officer is not sufficient to determine accounting system adequacy.

Finally, while disagreeing with specific mandates for pre-award audits set forth in the Alert Memo, BFA does agree that the scope and complexity of large facility awards requires that increased focus be placed on ensuring that proposed costs are reasonable, and that accounting systems are adequate to determine costs applicable to the award. BFA has previously informed the OIG that it plans to further strengthen internal procedures for completing pre-award reviews of recipient cost proposals and accounting systems associated with major construction awards. These plans, which have been set forth in documentation associated with NSF's annual Financial Statement Audit, will supplement procedures already in place at the agency by strengthening review of cost proposals and accounting system information with emphasis on the following critical areas: (1) assessment of the process employed by the recipient to estimate the elements of cost or price being analyzed, (2) validation of the application of rates and factors by the recipient, (3) review of proposed budgeted line items to requirements set forth in the applicable OMB cost principles, (4) comparative analysis of pricing information, (5) review of the adequacy of the recipient's accounting system and other systems as determined necessary for proper management of federal funds, and (6) determinations, on a case by case basis, of the level of DCAA or other independent audit activity that may be necessary to determine a cost proposal to include reasonable costs, and to obtain additional insight into the adequacy of an awardee's accounting system to properly account for and bill incurred costs.

Findings of the Defense Contract Audit Agency

A substantial portion of the Alert Memo summarizes audit activities performed by the DCAA on the OIG's behalf associated with three major construction awards. We first emphasize that we disagree with conclusions made in the Alert Memo that the projects in question include unsupported and unallowable costs, given that there has not yet been final resolution of the subject audit reports. Audit information referenced in the Alert Memo constitutes the findings of the DCAA offices and is pre-decisional prior to disposition of those findings by NSF. While in no way discounting the importance of investigating and resolving the DCAA findings in these matters, it is important to clarify that decisions as to the reasonableness of estimated costs for the award of a cooperative agreement are vested with the warranted Grants Officer. These decisions were made by NSF Grants Officers prior to award of the cooperative agreements in question. The proper venue for resolution of these audit findings is through procedures set forth in OMB Circular A-50 Audit Followup. Prior to completion of the procedures set forth in the Circular, we disagree with any statements set forth in the Alert Memo that audited costs are unallowable or unsupportable. Further, we take this opportunity to address the three major assertions made in the Alert Memo based on the DCAA audits conducted. These assertions are that NSF procedures are not adequate to: (1) address unallowable and unsupported costs contained within the cost proposals, (2) ensure that proposals meet acceptable standards for auditability, and (3) ensure that awardee accounting systems are adequate to properly bill incurred costs.

1. Unallowable and Unsupported Costs Contained Within Cost Proposals

At the core of the disagreement between the BFA and OIG as to the allowability of a significant portion of the costs questioned in the DCAA audits is the issue of inclusion of "contingency" estimates within the awardee's cost proposals. The issue of contingency estimates is cited repeatedly throughout the Alert Memo, and the significant contingency estimates that are included within the proposals audited are used by the OIG as a basis to assert the inadequacy of NSF's cost review procedures. However, the Alert Memo makes no acknowledgment of the inherent disagreement between BFA and the OIG specific to the allowability of contingency estimates for the purpose of establishing accurate cost estimates for large construction projects. In fact, NSF *requires* that awardees include contingency estimates within their proposal budget as a prerequisite to determining whether proposed costs are reasonable and sufficient for successful project execution, and NSF reviews those estimates for adequacy. While DCAA disagrees with the inclusion of contingency within these estimates, we note that their position on this matter is not determinative. Instead, the Office of Management and Budget (OMB), which is the cognizant federal agency responsible for establishing the cost principles cited by the DCAA and the OIG as prescribing contingency estimates as unallowable, has confirmed publically that the intended federal policy is for contingency amounts to be explicitly included in budget estimates for large construction projects to the extent that they are necessary to improve the precision of those estimates, that the amounts must be estimated using broadly-accepted cost estimating methodologies, and as such, that contingency amounts are to be *included in awards* and expended during project execution. It is important to note that this position, published in a Federal Register Notice issued February 1st, 2013, is stated as a clarification of OMB policy, not the establishment of new policy, and that explicitly for large facility awards the use of contingency estimates "is an acceptable and necessary practice, and that the method by which contingency funds are managed and monitored is at the discretion of the Federal funding agency." NSF has consistently followed this policy for the estimation of costs associated with large facility projects, and has codified the details of establishing sound contingency estimates within the agency's Large Facilities Manual, ensuring consistency of agency policies with relevant OMB Circulars as well as other authoritative government and industry guidance on this matter. We also note that consistent with procedures set forth in the OMB Circular A-50 previously cited in this document, BFA sought the opinion of agency legal counsel as to the allowability of contingency estimates within cost proposals based on that office's legal analysis of the applicable cost principles. This advice, provided to your office in 2011, supports the agency's position that amounts for contingency may be estimated and included in recipients' award budgets. Based on these facts, we consider the numerous statements within the Alert Memo classifying contingency estimates within budget proposals as unallowable to be flawed, and to be inconsistent with the governing cost principles as substantiated by OMB.

Ancillary to the issue of the *allowability* of contingency estimates included within awardee proposals is the issue of the *supportability* of these and other estimated costs used to establish a basis for award of major facility projects. The Alert Memo emphasizes that cost estimates must be adequately supported and documented, and cites numerous circumstances where DCAA maintains that adequate supporting documentation was not provided. We understand the gravity of DCAA findings that include statements that categories of estimated cost are unsupported. However, it must be again emphasized that these findings are pre-decisional to the cognizant federal agency's determination of the reasonableness of proposed costs prior to award, and that it is NSF Grants Officer, and not DCAA, that determines whether proposed costs are adequately supported to provide a basis for determining cost reasonableness. Normally, an agency would receive such DCAA assessments prior to award, as they are among the pre-decisional tools that can be used by a Grants Officer in finalizing the cognizant federal determination of reasonableness of proposed costs, prior to award. With respect to contingency estimates, NSF determined prior to award of the cooperative agreements that these estimates were supportable. We acknowledge that standards for supportability of contingency estimates applied by NSF and set forth in the NSF Large Facilities Manual differ from those applied by the DCAA, however, application of different standards by DCAA does not nullify the NSF standards or the analysis performed by the agency. For example, DCAA has determined to reject any awardee estimate of subcontracted materials or equipment cost used as a basis to support estimation of contingency associated with these charges, where the development of the contingency estimate is based on the escalation of a subcontractor quotation not current as of within 6 months of the analysis completed. Conversely, consistent with NSF procedures, reasonable escalation of quotations exceeding 6 months in currency, especially for unique, non-commercial, or highly complex items, is utilized by the agency to reasonably estimate costs associated with these items. For DCAA to state that such costs are "unsupported," is unreasonable. Similarly, DCAA has rejected use of standard NSF procedures allowing for the use of risk matrices to categorize the likelihood and severity of cost impacts of future events based not on the unreasonableness of these procedures, but based on the fact that DCAA cannot verify qualitative value judgments determined by expert engineering personnel in assigning risk values. BFA disagrees with the claim that these estimates are unsupported, especially based on independent reviews completed of the estimating methodology by outside independent experts, and the consistency of this type of analysis with widely accepted practices for establishing contingency estimates.

In addition to the issues associated with the allowability and supportability of contingency estimates contained within audited proposals DCAA has also questioned estimated costs associated with other elements of awardee proposals. These include, for example, estimates associated with direct labor, equipment, and materials necessary to execute the audited projects. The OIG determined these costs to be unreasonable prior to final resolution of the audit findings by the agency. In fact, the finalization and forwarding of audit information associated with one of the audits cited was provided to NSF for action on September 28th, 2012, the same date as the issuance of the final Alert Memo. NSF is currently in the process of resolving these audit findings. While this analysis has not yet been completed, the preliminary review by the Grants Officer has found that many of the costs questioned by DCAA are, in fact, supportable. This circumstance raises further issues with the OIG assertion that significant portions of audited costs reviewed under the three proposals are unallowable or unsupportable.

As a final comparative analysis, we note that at the macro level, DCAA's own cognizant Office of Inspector General, through issuance of that Office's Semi-Annual Report to Congress, confirms that for audits where statistics are available (post-award contract actions), DCAA recommended cost disallowances are sustained by government contracting officers in less than 46% of circumstances tracked by the agency (based on analysis of DoD Office of the Inspector General Semi-Annual Reports for the previous three fiscal years). While each situation where DCAA has determined a cost to be unallowable or unsupportable must be addressed separately based on the individual circumstances of the action, these statistics substantiate that the final determination of the reasonableness of cost estimates can only be evaluated after disposition of audit recommendations by the cognizant Contracting or Grants Officer. Thus, audit findings alone should not be used to draw conclusions as to the reasonableness of proposed costs until disposition of the findings by the awarding agency.

Based on the foregoing, BFA is concerned with broad statements contained in the Alert Memo questioning $305 million "in unallowable and unsupported cost" associated with the referenced projects prior to resolution of the audit reports cited in the document. Substantive disagreement between the OIG and BFA as to the allowability and supportability of these costs exists, as illustrated above, and BFA believes that these issues should be resolved through the procedures set forth in OMB Circular A-50.

2. Acceptable Standards for Auditability

The Alert Memo states that cost proposal information provided by the three awardee organizations audited by DCAA were in many circumstances determined to be "unacceptable for audit." Associated with this issue of auditability, the OIG asserts that awardees cannot readily provide the necessary supporting documentation for their proposed budget estimates to third parties, that proposal information cannot withstand independent review, and that problems with NSF's current process for evaluating cost proposals are illustrated by the fact that proposals lack sufficient information to conduct an audit or determine a fair and reasonable price. BFA disagrees with this assessment. First, we note that each of the three organizations audited did in fact meet the standards for cost proposal submissions that were required by the cognizant federal agency (NSF) prior to award of cooperative agreements. Further, the proposal audits were completed and received over one year after the subject awards were made. The DCAA audits levied separate proposal submission requirements, and cost element documentation requirements, that had not been required by NSF prior to award. These documentation requirements included cost element format, granularity, and supporting documentation details far in excess of NSF prescribed standards. In that awardee organizations could not match original cost estimate information to retroactively prescribed standards, the proposal information, as cited in numerous circumstances within the Alert Memo, was determined to be "inadequate for audit." The audits conducted by DCAA prescribed standards for auditability inconsistent with those that had been originally established by the agency responsible for determining the level of detail necessary to review cost proposal information. Although the OIG may disagree with the established NSF policies that required cost detail information be submitted at a less granular level than subsequently required by DCAA, to retroactively prescribe different documentation standards, and then to characterize problems with an organization's inability to match data to original proposal estimates, is inconsistent with standard audit practices. This problem is exacerbated by the fact that the awardees were required to develop this additional information over one year after award of the agreements. Further, it is BFA's position that many of the DCAA data submission requirements levied were unreasonable as previously illustrated, (e.g., requiring that all quotations for subcontracted support be validated through recent subcontractor quotations), and more consistent with application of standards for determining cost reasonableness for contract awards requiring certified cost or pricing data than for standards prescribed by NSF for the review of financial assistance awards for large facilities projects. Standards used by NSF that were not considered in the DCAA audits include not only those set forth in the NSF Large Facilities Manual, but also those contained within NSF's Definition and Use of Contingency Resources in NSF Facility Construction guidance, and the NSF Proposal & Award Policies and Procedures Guide. We believe these were the causational factors leading to delays in DCAA obtaining detailed information on a timely basis, including problems with the auditability of proposals.

3. Adequacy of Awardee Accounting Systems

The Alert Memo asserts that based on the fact that NSF does not require pre-award cost accounting system audits of awardees as a mandatory prerequisite of large facility construction awards, the agency cannot determine accounting systems to be adequate to bill the government properly. A recently completed accounting system audit performed by DCAA on the OIG's behalf is referenced as indicative of this circumstance, stating that the audit determined the organization's accounting system inadequate to account for government funds, and that the organization was not eligible for advanced payments because its accounting system did not meet OMB and NSF financial management standards in eight significant areas. As the OIG is aware, the referenced audit was resolved by NSF in 2011, and corrective action taken to address the accounting system deficiencies identified in the report. Further, as previously related in this Memorandum, BFA has stated that internal procedures are already being evaluated and updated to ensure that pre-award cost accounting system reviews of prospective awardees are initiated, when necessary, based on the pre-award review of information available to the Grants Officer to determine system adequacy. We also note that related to the three organizations that were the subject of the audits referenced in the Alert Memo, all were considered to have adequate financial systems prior to award of the cooperative agreements. Subsequent to the awards, each organization has been subjected to scrutiny under the BSR program. These efforts are at varying stages in the review process, but no adverse findings have been made concerning the adequacy of the recipients' accounting systems. (A more substantive discussion of the NSF BSR process is set forth in a subsequent section of this Memorandum.) Based on these facts, BFA continues to maintain the position that pre-award accounting system audits should be initiated by the agency based on a review of the specific circumstances of the award, and not as a prerequisite for all large facility projects.

Requirements for Obtaining Reviews of Incurred Cost Submissions

The Alert Memo states that cooperative agreement awards for large facility projects should be subject to annual incurred cost audits. While BFA agrees that strong cost surveillance procedures are required for large facility projects, especially based on the substantial dollar value of these actions, BFA disagrees with a mandate for annual incurred cost audits for all awards exceeding $50M in value. Instead, BFA advocates post award review of incurred costs building on pre-established federal post-award audit requirements, and addressing the need for additional reviews based on award risk. BFA believes this position to be consistent with the legal and regulatory requirements governing such audits.

OMB Circular A-110, Sec. 26 Non-Federal Audits, states that "Recipients and sub-recipients that are institutions of higher education or other non-profit organizations (including hospitals) shall be subject to the audit requirements contained in the Single Audit Act Amendments of 1996 (31 USC 7501-7507) and revised OMB Circular A-133, "Audits of States, Local Governments, and Non-Profit Organizations." Further, OMB Circular A-133 states that audits conducted in accordance with the Circular shall be in lieu of any financial audit required under individual Federal awards, and to the extent that such A-133 audits meet Federal agency's needs, they shall rely upon and use such audits. This policy does not limit the authority of Federal agencies, including their Inspectors General or the U.S. General Accounting Office, to conduct or arrange for additional audits (e.g., financial audits, performance audits, evaluations, inspections, or reviews) nor does it authorize any auditee to constrain Federal agencies from carrying out additional audits. However, the Circular requires that any additional audits be planned and performed in such a way as to build upon work performed by other auditors. (Ref. § .215 Relation to other audit requirements). Based on these facts, BFA considers the OIG recommendation that agency initiated accounting system audits be mandated as a requirement for all individual financial assistance awards exceeding $50M to be inconsistent with OMB Circular A-133, to the extent that it mandates such audits in all circumstances versus a determination by the agency that additional audits are necessary. We are especially concerned with the OIG statement that "absent incurred cost submissions or their equivalent, NSF cannot adequately monitor awardees' expenditure of federal funds during the post award stage." This statement would seem to contradict long standing federal practices that make annual incurred cost audits of financial assistance awards an exceptional circumstance, not a standard process prescribed in regulation as necessary to monitor incurred costs.

In addition to complying with OMB A-133 single audit requirements, NSF ensures the adequacy of the financial system of each large facility project awardee for properly billing incurred costs by performing periodic cost accounting system reviews following procedures set forth in the NSF *Business Systems Review (BSR) Guide*. The NSF BSR Guide establishes and defines the overall framework, structure, awardee expectations and details regarding business system reviews for NSF large facilities. These reviews have been developed specifically to address the higher level of risk associated with major facility awards. BSR reviews include focus on awardees' accounting systems and policies and procedures, and facilitate determining the suitability and financial viability of awardees. A major principle of the financial system review is that the awardee have an adequate accounting system that is compliant with the applicable generally accepted cost principles (2 CFR 220, 2 CFR 230, FAR Part 31), administrative requirements (2 CFR 215), and internal policies and procedures. Explicit in this review is that the awardee has filed required OMB Circular A-133 reports with the single audit clearinghouse and that the awardee is actively resolving any outstanding audit findings with the cognizant federal agency. If an organization's financial systems are determined to be incomplete or inadequate, recommendations that funding be either postponed or not provided to the organization are made.

Based on the application of the above prescribed standards to the three cooperative support agreements referenced in the Alert Memo, we first note that each of the three have successfully completed A-133 Audits, and no internal control deficiencies have been identified that would indicate any inadequacies in their respective accounting systems. Additionally, each awardees' accounting systems has been subjected to review to varying degrees under NSF's Business System Review program. To date, only limited instances of unallowable costs billed to NSF awards have been identified, and these matters have been successfully resolved. We further note that the Alert Memo makes no acknowledgment of post award cost monitoring controls that are currently in place by NSF for prior agency approval of the use of contingency expenditures associated with these awards, as has been codified by modifications to the applicable cooperative agreements. While not acknowledging these post award cost monitoring procedures currently in place at the agency, the Alert Memo instead highlights delays in obtaining incurred cost audits that the OIG has initiated, citing numerous examples of these circumstances and stating that "these waiting periods are inordinately long, and demonstrate the problems with NSF's post-award monitoring processes." However, it is the BFA position that delays in obtaining cost incurred audit information from awardees are instead driven by these organizations' lack of experience in providing cost documentation information in a format, and at the detail level, prescribed by DCAA for incurred cost submissions. As already acknowledged by the OIG, these organizations are not otherwise subject to annual incurred cost audits for other federal financial assistance programs, and many times do not have separate federal contract awards subject to government Cost Accounting Standards (CAS). The fact that non-CAS covered organizations experience challenges in producing data meeting DCAA documentation standards is not, we believe, unexpected.

Finally, we note that in addition to the cost monitoring controls set forth above, BFA has previously disclosed to the OIG an initiative to commission the use of incurred cost audits for major large facility cooperative agreements, when necessary, and following an agency risk analysis to determine the level of post-award audit review appropriate. Guidance is being developed by the agency that will clarify post-award monitoring requirements to both strengthen current procedures (which include the use of A-133 audits and internal cost monitoring of recipient costs by NSF personnel) and to address the use of audit resources when appropriate. Given that post award audit activity is not mandated by financial assistance regulation, NSF is also working to identify a process to obtain resources for this initiative prior to committing to the completion of outside audits versus adequate verification that incurred costs are reasonable through alternate methodologies.

Use of Standard Form 424 to Segregate Allowable and Unallowable Costs and to Provide Greater Visibility

The Alert Memo states that NSF does not require the use of OMB Standard Form 424C "Budget Information – Construction Programs," which would allow for clear identification of allowable and unallowable costs, as well as amounts for contingency, in an awardee's budget proposal. The OIG concludes that without use of this, or an equivalent form or process, awardees are not required to segregate allowable from unallowable costs in proposal budgets, increasing the risk that NSF will unknowingly fund unallowable costs, will preclude stakeholder assessment of project risk, and will increase the difficulty of tracking expenditures of certain funds in an awardee's accounting system.

Through our response to NSF Audit Report No. 12-2-010 "Audit of NSF's Management of Contingency in the EarthScope Awards," issued in September 2012, NSF has separately agreed to require awardees to use Standard Form 424C, or an equivalent form, to identify amounts needed for contingencies, and to distinguish between allowable and unallowable costs, when submitting proposals for major facility projects. However, please note that NSF has not previously required use of Form 424C based on the fact that the form is not mandatory for agency financial assistance awards (reference 2 CFR 215.12(b)), and NSF has already developed procedures that are utilized for proposal evaluation to ensure that unallowable costs are not funded in the awards. Given current agency standards for preparing and presenting construction cost estimates, use of Standard Form 424C is considered to be redundant, and in fact NSF currently requires that prospective awardees provide more detailed cost proposal information than required by the form. Notwithstanding this fact, the agency is currently working to provide increased standardization to the summary presentation of awardee construction cost work books when identifying contingency estimates, as well as presentation of these estimates on NSF Form 1030. While NSF works to implement these improvements, we emphasize that cost book information submitted by awardees is already required to separately identify contingency estimates distinct from other estimated cost elements. This separate identification of contingency enhances, and does not inhibit, stakeholder assessment of project risk. Concerning the issue of separate tracking of contingency estimates, please see our response provided on this subject in the subsequent section of this document.

While BFA disagrees with the use of Form 424C as a prerequisite to proper identification of unallowable costs, we do highlight that the form, which is prescribed by OMB as mandatory unless alternate forms are approved for agency use, follows procedures consistent with NSF's interpretation with the development and expenditure of contingency estimates. First, please note that Form 424C related to budget proposals determines "TOTAL PROJECT COSTS" (Line 16) inclusive of "Contingencies" (Line 13) prior to computation of costs eligible for federal assistance, which is inconsistent with the OIG position that contingency estimates are to be excluded from direct funding by the awarding agency, and must be held separately outside of the award estimate. Further, and again consistent with NSF development of contingency estimates, we note that contingency is identified as a distinct and separate line item distinguished from other proposal cost elements, versus the OIG assertion that contingency estimates must be specifically assigned to individual cost elements of a proposal, including contingency costs that are estimated for use associated with indirect costs.

Accounting of Contingency Funds and Separate Tracking of Budgeted Versus Actual Contingency Costs

The Alert Memo asserts that NSF allows its awardees to commingle contingency costs in other categories of direct cost on their proposal cover sheets, and that awardees are not required to identify the amount of contingency costs that are estimated will be used for indirect costs. The Memo further states that without requiring this information in proposals, NSF lacks assurance that awardees will properly account for and track contingency expenditures or segregate unallowable costs in claims to the government. Finally, the Memo states that based on lack of insight into contingency estimates used to determine contingency budgets prior to funding expenditures, and the fact that contingency expenditures are not separately accounted for by recipients in their accounting systems, NSF has no insight into how contingency funds are expended in comparison to amounts originally budgeted and approved.

The OIG position on this matter conflicts with both NSF and industry standard practices for properly managing contingency estimates. Contingency estimates are developed in accordance with broadly-accepted industry and government practices to provide greater precision in budget estimates and to fully account for costs anticipated to be incurred during project execution. Application of these broadly accepted practices does not yield cost data disaggregated by cost element, (e.g., the separate identification of contingency estimates to be allocated to indirect costs), rather it results in an aggregate amount that is added to the estimate to account for cost, technical, and schedule risk. Estimates within the initially approved budget are not actual incurred costs, they are forecasts, based on best practices and information of what the parties may expect the costs to be. During construction, NSF monitors anticipated expenditures, including those requiring calls on contingency. Unique or special tracking of contingency estimates is not necessary once anticipated costs are identified and the authorization process to increase the project's baseline budget authority has been accomplished. Once budget is allocated from contingency to the project work breakdown structure via the project change control process, expenses for labor, materials, supplies, equipment, services, and other items of cost are recorded within the awardee's accounting system the same as other items estimated within the project budget. Progress is continually monitored, including allocations from contingency, via monthly Earned Value Management reports and other oversight techniques. It is also important to note that contingency is unallocated budget; it is allocated to a particular WBS category and becomes part of the budget during project execution when the project manager expects that its expenditure will be necessary to accomplish a specific work package of related WBS elements. The reverse process also occurs, where expected or realized underruns result in augmentation of the contingency budget, whose funds are not identified with any specific cost category. Once contingency in the budget estimate has matured into an actual cost, the applicable cost principles are applied to ensure that such incurred costs to be paid by the Government are allowable. At that point however, the expense is not for a contingency reserve, which is prohibited by the cost principles; rather, it is a specific item of incurred cost. As a final note, as the OIG is aware, NSF has instituted additional controls for prior agency approval of significant contingency expenditures, as has been codified by modifications to existing cooperative agreements for major facility projects. These controls are being further strengthened through post-award monitoring of awardee incurred costs as summarized in this document.

Selection of Award Instrument

Finally, we note that the introductory paragraphs of the Alert Memorandum present context and an overarching framework to underpin its summary of audit findings, conclusions, and associated recommendations related to NSFs oversight of large facility construction awards. In short the Alert Memorandum implies that an agency's choice of funding vehicle, assistance vs. procurement, is purely discretionary; that cooperative agreements are neither subject to rigorous oversight, nor transparent as to transactions; and, by inference, that NSF has, by using such funding arrangements, introduced an unacceptable level of financial and technical risk to this portfolio of awards. A paraphrased statutory citation from the Federal Grant and Cooperative Agreement Act is used as initial support for this framework, supplemented throughout the memorandum with references to requirements that may be used with procurement instruments.

> The Federal Grant and Cooperative Agreement Act prescribes use of "a procurement contract as the legal instrument reflecting a relationship between the United States Government and a State, a local government, or other recipient when—
>
> > **(1)** the principal purpose of the instrument is to acquire (by purchase, lease, or barter) property or services for the direct benefit or use of the United States Government; or
> >
> > **(2)** the agency decides in a specific instance that the use of a procurement contract is appropriate."

The wording of the legislative cite, 31 USC 6305, that discusses the use of cooperative agreements reads,

> An executive agency *shall* use a cooperative agreement as the legal instrument reflecting a relationship between the United States Government and a State, a local government, or other recipient when—
>
> > (1) the principal purpose of the relationship is to transfer a thing of value to the State, local government, or other recipient to carry out a public purpose of support or stimulation authorized by a law of the United States instead of acquiring (by purchase, lease, or barter) property or services for the direct benefit or use of the United States Government; and

> (2) substantial involvement is expected between the executive agency and the State, local government, or other recipient when carrying out the activity contemplated in the agreement.

Contemplating both the transfer of "a thing of value...to carry out a public purpose" and substantial involvement, the agency has flexibility to develop funding arrangements with degrees of rigorous oversight and review appropriate to the unique attributes of the awardee, the program, and the sponsor's needs. Consistent with the statute, NSF uses the cooperative agreement funding instrument for its large facilities construction awards. Exercising its associated sponsor prerogatives, NSF includes additional requirements in those agreements, and provides more rigorous oversight as compared to the rest of its assistance portfolio.

As previously noted, the NSF Director recently commissioned a review of the Large Facility policies and procedures that will likely result in even more rigor, applied through an enhanced risk mitigation framework. This effort is a capstone to our commitment to overall process improvement that we have made throughout our extensive interactions with the Office of the Inspector General since the issuance of the original DCAA audits.

MEMORANDUM SUBMITTED BY CHAIRMAN LAMAR S. SMITH

National Science Foundation
4201 Wilson Boulevard
Arlington, Virginia 22230

Office of Inspector General

MEMORANDUM

DATE: September 28, 2012

TO: Jeff Lupis, Director
Division of Acquisition and Cooperative Support (DACS)

FROM: Dr. Brett M. Baker /s/
Assistant Inspector General for Audit

SUBJECT: NSF OIG Audit Report No. OIG-12-1-008, Audit of National Ecological Observatory Network, Inc's Proposed NEON Construction Budget

We contracted with the Defense Contract Audit Agency (DCAA), Denver Branch Office, to perform an audit of National Ecological Observatories Network's (NEON) $433.7 million proposed budget for the construction of the National Ecological Observatories Network, which will be performed over a five-year period from August 1, 2011 through July 30, 2016. The objective of this audit was to examine the NEON construction proposal to determine if NEON's proposed budget was prepared in accordance with applicable federal requirements, and is acceptable as a basis for negotiation of a fair and reasonable price.

DCAA performed its audit of NEON in accordance with generally accepted government auditing standards using OMB regulations as criteria. However, the auditors reported significant scope limitations because neither NSF nor NEON provided adequate supporting documentation for significant proposed quantities or costs. DCAA's final audit report is attached to this memo.

Background

The NEON proposal audit started in June 2011 and on July 25, 2011, DCAA issued its first of three inadequacy memos stating that the NEON proposal was unauditable. On July 27, 2011, NSF entered into Cooperative Agreement EF-1029808 and a Cooperative Support Agreement (CSA) EF-1029808 with NEON both effective August 1, 2011. The CSA initially funded the NEON project with $12.5 million of Major Research Equipment and Facilities Construction (MREFC) funds out of the projected total award funding of almost $434 million subject to availability of funds. At present, through the latest award modification (Amendment 014, dated September 17, 2012), the cumulative CSA funding is approximately $72.8 million.

On September 16, 2011, DCAA issued its final inadequacy memo, which we formally issued to NSF on September 30, 2011. [1] On February 17, 2012, NEON submitted a revised proposal, and on March 1, 2012, DCAA acknowledged that it would audit this proposal. The attached DCAA audit report is the result.

Significant issues and limitations discussed in DCAA's audit report are explained below.

Conclusion

Despite working with NEON between January through September 2012 to proceed with the audit and clear some major inadequacies in the proposal, the auditors issued an adverse opinion on the proposal stating that the proposal did not form an acceptable basis for negotiation of a fair and reasonable price. DCAA's audit of the NEON construction proposal disclosed significant questioned and unsupported costs of $154.4 million (nearly 36% of the proposed $433.7 million budget). Costs questioned were $102.1 million and costs unsupported were $52.3 million. These exceptions occurred because the proposed budget was not prepared in accordance with appropriate provisions of OMB Circular A-122 (2 CFR Part 230), Cost Principles for Non-Profit Organizations. Because the noncompliances with these cost principles have a significant impact on the proposal taken as a whole, DCAA rendered an adverse opinion on the proposed budget.

NEON's proposed budget and DCAA's questioned and unsupported costs, as summarized in the Exhibit (page 5 of DCAA's audit report), are as follows:

		Results of Audit		
Cost Element	Proposed	Questioned	Unsupported	Difference
Direct Labor	$ 87,755,598	$ 9,102,121	$ 5,053,736	$ 73,599,741
Materials	14,635,610		13,246,257	1,389,353
Equipment	107,457,147	3,222,854	16,599,842	87,634,451
Travel	9,471,314	1,735,279		7,736,035
Other Direct Costs	73,604,605	13,438	7,485,228	66,105,939
Consultants	32,307,025	2,005,697	9,913,285	20,388,043
Escalation-Other	24,025,612	12,645,354		11,380,258
Overhead	11,858,840	731,640		11,127,200
Contingency	72,683,017	72,683,017		
	$433,798,768	$102,139,400	$52,298,348	$279,361,020

[1] NSF OIG Audit Report No. OIG-11-1-021, *Evaluation of National Ecological Observatory Network's (NEON) Construction Proposal,* dated September 30, 2011

Significant issues supporting DCAA's adverse opinion include the following:

- The audit questioned the entire $72.6 million of proposed contingency costs as unallowable based on 2 CFR Part 230, Appendix B, Paragraph 9, *Contingency Provisions*, which states, "Contributions to a contingency reserve or any similar provision made for events the occurrence of which cannot be foretold with certainty as to time, intensity, or with an assurance of their happening are unallowable." DCAA noted that there is uncertainty that the costs will be incurred. NEON calculated $57.2 million of contingencies for line items using values and factors from tables, and estimated an additional $15.4 million for changes in overall project estimate and increases in project contingency from 16 to 20 percent as recommended in NSF's Final Design Review. Although NEON asserted its proposed contingency estimating calculations were used in a wide variety of scientific and commercial projects, DCAA stated that, " NEON could not support the proposal's contingency values and factors for subject project using its own historical data. Nor was other data available to support the proposed values and factors." The cited OMB cost principle notwithstanding, the awardee is still required to provide adequate supporting documentation for all its proposed costs, in accordance with 2 CFR 230 Appendix A, General Principles, A(2)(g), which requires costs be adequately documented.
- The audit questioned proposed escalation costs because auditors found the escalation factors to be unreasonable, inappropriate, or duplicate escalation costs; NEON did not appropriately apply the NSF-provided OMB escalation factors; or Global Insight's producer price index showed deflation over the period of performance rather than inflation.
- NEON did not provide adequate documentation to demonstrate the allowability, allocability, or reasonableness for significant amounts of the proposed direct labor, direct material/equipment, consultants, and other direct costs (ODCs).
- NEON did not always provide adequate documentation to demonstrate price reasonableness of the proposed unit price for several material items.
- NEON's price and/or cost analyses were insufficient due to (i) reliance of historical data that was not current; (ii) lack of adequate documentation of the analyses; and (iii) less than sufficient competition by offerors.
- Questioned and unsupported direct equipment and material costs are based on inadequate supporting documentation, unsupported engineering estimates, unsupported estimated shipping costs, quantity discounts not taken, and other exceptions.
- NEON proposed a management fee as a line item of consultants cost to cover expressly unallowable costs in noncompliance with OMB cost principles.
- Questioned travel costs included inappropriate refund application and unallowable food and alcohol costs.
- Questioned unit costs for ODCs (other direct costs) and consultant costs included items that did not reconcile to support, such as vendor quotes.
- NEON's accounting practice is noncompliant because it incurred but did not remove unallowable indirect costs from the overhead pool and is not accounting for capital expenditures in accordance with OMB cost principles which state, "Equipment and other capital expenditures are unallowable as indirect costs."
- NEON's MTDC (modified total direct costs) allocation base was determined to be noncompliant with OMB cost principles because NEON removed unallowable costs from the

allocation base, which has the effect of lowering the base and increasing the rate for the remaining costs left in the base. Unallowable costs should also receive an appropriate share of indirect costs.

- NEON did not include the proposed contingency costs in its allocation base in proposing its 22 percent overhead rate or apply its overhead rate to the proposed contingency costs. Therefore, it appears NEON has not considered the potential accounting issues that could arise from these costs.
- The fringe allocation base selected by NEON was determined to be noncompliant with OMB cost principles. NEON included the following two accounts in the base: Account 40101, *Part Time and Temporary Salaries,* which contained costs of visiting scientists and seasonal workers, and Account 40105*, *Other Compensation*, which contains cost for signing bonuses, severance costs, and other items of this nature. NEON confirmed visiting scientists and seasonal workers do not receive benefits.

NEON, in its response dated September 7, 2012, disagreed with DCAA's findings, stating that "costs were estimated and thoroughly reviewed (by NSF panels) consistent with NSF's MREFC procedures defined in the NSF Large Facilities Manual." We take no exception to the factual accuracy of NEON's assertion. However, the significant marked contrast in results between NSF panel reviews which took no exception to NEON's proposed costs and the subject DCAA audit raises serious concerns about the NSF review processes. Similar differences and awardee assertions arose over two other NSF construction projects during the last two years. DCAA audits, which use OMB cost principles as criteria, have repeatedly found awardees' proposed budgets (that were approved by NSF) lacked adequate supporting documentation. Please see our recent alert memo to NSF for further details.[2] Our overarching goal is stewardship and accountability of government funds.

Scope Limitations

DCAA noted significant scope limitations which prevented a complete audit of the proposal, and, without which, additional costs might have been questioned. First, DCAA was unable to determine the reasonableness of proposed direct labor hours or material and equipment quantities. While NSF OIG provided DCAA with NSF's panel reviews (Final Design Review and Construction Readiness Review), DCAA could not rely on those reviews as technical evaluations. DCAA stated that those reviews did not provide the detail, nor satisfy the requirements of a technical evaluation. We asked NSF to provide a program review of NEON's proposed labor hours and documentation quantifying and justifying the amount of NEON's proposed labor hours (by category) and skill levels. NSF responded that its Design review evaluates staff and skill levels using the NSF Large Facility Manual criteria, and that the Grants Officer "performs a cursory check of the labor hours as it appears in the NSF budget form." We forwarded NSF's responses to DCAA, but DCAA still could not rely on NSF's processes as a legitimate technical evaluation.

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[2] NSF OIG Alert Memo, Report No. 12-6-001, *NSF's Management of Cooperative Agreements*, dated September 2012

Second, DCAA stated that NEON did not provide adequate support for a significant portion of its proposed direct labor, materials, equipment, ODC (other direct costs) and consultant costs. As stated above, this resulted in DCAA's classifying approximately $52.3 million of proposed direct costs as unsupported. This amount does not include the application of NEON's proposed 22% indirect cost rate, which, if applied, would have the effect of increasing the $52 million by as much as $11.5 million ($52.3 million x .22). However, DCAA stated that the contracting officer should apply this rate to any unsupported base costs that are not accepted to calculate corresponding additional questioned indirect costs.

Recommendations

In view of the adverse opinion rendered by the auditors on NEON's construction proposal and the almost $434 million of taxpayer dollars at risk, we recommend that the NSF Director of the Division of Acquisition and Cooperative Support take the following actions before funding any additional amounts for the NEON project:

1. Require NEON to submit a revised proposed budget with adequate supporting documentation for all proposed costs.
2. Obtain a DCAA audit of the awardee's revised proposed budget and supporting documentation prior to funding and base NEON funding on the results of audit.[3]
3. Require NEON to remove unallowable contingency provisions from its proposed budgets for NEON and discontinue NSF's practice of funding contingencies until the awardee is able to demonstrate a bona fide need for the funds supported by adequate supporting documentation.

In accordance with OMB Circular A-50, please coordinate with our office during the six-month resolution period to develop a mutually agreeable resolution of the audit findings. Also, the findings should not be closed until NSF determines that the recommendation has been adequately addressed and the proposed corrective actions have been satisfactorily implemented.

We are providing a copy of this memorandum to the NEON Program Director and the Director of Large Facilities Projects. The responsibility for audit resolution rests with DACS. Accordingly, we ask that no action be taken concerning the report's findings without first consulting DACS at (703) 292-8242.

OIG Oversight of Audit

To fulfill our responsibilities under generally accepted government auditing standards, the Office of Inspector General:

- Reviewed DCAA's approach and planning of the audit;

[3] DCAA stated in its report, "If NEON provides the remainder of the supporting documentation prior to re-negotiations under the adjustment clause, we will provide a supplemental report, if such a report will serve a useful purpose."

- Evaluated the qualifications and independence of the auditors;
- Monitored the progress of the audit at key points;
- Coordinated periodic meetings with DCAA and NSF officials as necessary to discuss audit progress, findings and recommendations;
- Reviewed the audit report prepared by DCAA to ensure compliance with Government Auditing Standards and Office of Management and Budget Circulars; and
- Coordinated issuance of the audit report.

DCAA is responsible for the attached audit report on NEON and the conclusions expressed in that report.

We thank you and your staff for the assistance extended to us during the audit. If you have any questions about this report, please contact Jannifer Jenkins at (703) 292-4996 or David Willems at (703) 292-4979.

Attachments:

DCAA Audit Report No. 3121-2012J21000001-S1, *Independent Audit of National Ecological Observatory Network, Inc.'s Proposal for Major Research Equipment and Facilities Construction of the National Ecological Observatory Network,*, dated September 30, 2012

cc: Martha Rubenstein, CFO and Director BFA
Mary Santonastasso, Division Director, DIAS
Elizabeth Blood, NEON Program Director, Division of BIO
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MEMORANDUM SUBMITTED BY CHAIRMAN LAMAR S. SMITH

National Science Foundation
4201 Wilson Boulevard
Arlington, Virginia 22230

Office of Inspector General

MEMORANDUM

DATE: November 20, 2014

TO: Jeffery Lupis, Director
Division of Acquisition and Cooperative Support (DACS)

FROM: Dr. Brett M. Baker
Assistant Inspector General for Audit

SUBJECT: NSF OIG Audit Report No. OIG-15-1-001, *Independent Audit Report on National Ecological Observatory Network, Inc.'s Accounting System*

We contracted with the Defense Contract Audit Agency (DCAA) to perform an audit of National Ecological Observatory Network, Inc.'s (NEON) accounting system. The purpose of this audit was to determine if NEON's accounting system is in compliance with grant terms. DCAA issued two reports: an audit report with a recommendation regarding NEON's practices, which is attached to this memo; and a letter with observations and recommendations concerning NSF's grant policies and guidance to awardees, which will be issued via a separate transmittal.[1]

Background

In 2012, DCAA audited NEON's construction proposal budget.[2] DCAA rendered an adverse opinion on NEON's proposal since the audit disclosed significant questioned and unsupported costs of $154.4 million (nearly 36% of the proposed $433.7 million budget). We contracted for an accounting system audit because of the significance of the findings in that report.

Summary and Basis for Adverse Opinion

DCAA found three instances of material noncompliance, rendered an adverse opinion, and stated, "because of the significant effect of the noncompliance, NEON's accounting system does not comply with grant terms." The three instances of noncompliance are described in the Statement of Conditions and Recommendations as follows:

1. NEON's practice of recording time charges is noncompliant with its written policy.
2. NEON's indirect cost structure did not comply with 2 CFR Part 230.
3. NEON's indirect cost principles did not comply with 2 CFR Part 230.

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[1] NSF-OIG Report No. 15-6-001, *Observations that Warrant NSF's Attention Found During Audit on National Ecological Observatory Network, Inc.*
[2] NSF-OIG Report No. 12-1-008, *Audit of NEON, Inc.'s Proposed NEON Construction Budget*, dated September 28, 2012

Regarding material noncompliance no. 1, DCAA found that NEON's timekeeping practices (charging time on a weekly basis) are noncompliant with its written policies and procedures (requiring charging time on a daily basis). DCAA stated, "This condition could lead to misallocations between contracts and increased costs to the Government (if the employee records total hours incorrectly or records commercial hours on a Government contract)." NEON stated that it would update its policies and procedures in FY 2015 to require time reporting on a weekly basis, but did not provide DCAA a copy of its revised policies and procedures for review or confirmation as of the date of DCAA's report.

The other two material noncompliances (nos. 2 and 3 above) were corrected during the course of DCAA's fieldwork. As for no. 2, beginning October 1, 2013 (and continuing into FY 2014), NEON changed its indirect cost allocation method from the noncompliant simplified allocation method to the proper multiple allocation method. As for no. 3, during FY 2013, NEON revised its accounting practice to include unallowable costs in its G&A base to comply with 2 CFR 230.

Scope Limitation

DCAA also reported a scope limitation stating that "...we are unable to determine how much of the $74.2 million in contingency funds may have been used for unapproved scope changes." Specifically, DCAA was unable to determine how much of the contingency funds that NEON had used from August 2011 to March 2013 (approximately $4.5 million according to NEON's Contingency Log) may have been used for unapproved scope changes.

The $74.2 million was the approved contingency budget as of the award effective date (August 1, 2011), of which $12.4 million had been spent through June 2014, according to the table DCAA received from NEON below.

Award No.	Awardee	Award Title	Approved Contingency Budget as of the Award Effective Date	Amount Returned to Contingency through Jun 2014	Contingency Spend FY14 (Oct 2013 - Jun 2014)	Contingency Spend Award-to-Date
1029808	National Ecological Observatory Network, Inc.	CSA for MREFC of the NEON	$74,174,000	$1,253,566	$1,964,702	$12,430,815

NEON maintains a Contingency Log in which it captures approved budget for contingency expenditures to be made from "contingency funds." The contingency fund estimate represents the portion of the project construction budget to account for unknowns relative to requirements and the uncertainty that are within the scope of the project. DCAA verified that NEON received NSF approval for contingency requests greater than the NSF-specified threshold of $150,000. However, the majority of the changes were below the threshold, so NSF approval was not obtained for those changes. Also, during the audit, DCAA identified possible use of contingencies for unapproved scope changes.

The report notes that DCAA requested a technical evaluation from NSF-OIG to determine whether NEON's expenditures (of contingency funds) were changes in the scope or the objective of the project or program. We were unable to provide the technical evaluation because an independent technical assessment of the NEON project is outside of our mission and expertise, and we were requested to make this determination without involving NSF. DCAA further stated that, had it completed its planned procedures (i.e., received a technical evaluation), it may have identified additional noncompliances.

We believe that DCAA's request warrants an answer by NEON program officials with the expertise, because of the need to determine if NEON obtained prior written approval from NSF if changes in scope or objective occurred, in accordance with 2 CFR 215.25(h).

Recommendations

We recommend that the NSF Director of the Division of Acquisition and Cooperative Support take appropriate action to ensure that the uncorrected material noncompliance and the scope limitation cited in DCAA's report are fully addressed and corrected before funding any additional amounts for the NEON project. Such action would include requiring that NEON:

1. immediately notify all of its employees that they are required to enter their time in accordance with NEON's Policies and Procedures Manual;
2. review all of its expenditures of contingency funds (with particular attention to those under the $150,000 NSF approval threshold) to determine if any represent changes in the scope or the objective of the project or program, and submit a certifying statement with the results of this review to NSF; and
3. establish written policies and procedures to request prior written approval from NSF for any changes in the scope or objective of the project or program to ensure compliance with 2 CFR 215.25(h).

In accordance with OMB Circular A-50, please coordinate with our office during the six-month resolution period to develop a mutually agreeable resolution of the audit findings. Also, the findings should not be closed until NSF determines that the recommendations have been adequately addressed and the proposed corrective actions have been satisfactorily implemented.

We are providing a copy of this memorandum to the NEON Program Director and the Director of Large Facilities Projects. The responsibility for audit resolution rests with DACS. Accordingly, we ask that no action be taken concerning the report's findings without first consulting DACS at (703) 292-8242.

OIG Monitoring of Audit

To fulfill our monitoring responsibilities, the Office of Inspector General:

- Reviewed the approach and planning of the audit;
- Evaluated the qualifications and independence of the auditors;
- Monitored the progress of the audit at key points;
- Coordinated periodic meetings with DCAA and NSF officials as necessary to discuss audit progress, findings and recommendations;
- Reviewed the report prepared by DCAA; and
- Coordinated issuance of the report.

DCAA's draft on NEON's accounting system cited eight significant deficiencies and differed significantly from this final report, which found that NEON's timekeeping practices did not comply with its policies and procedures, but did not include all of the previously cited deficiencies. As an independent audit agency, DCAA provides its conclusions in accordance with auditing standards, and the OIG does not control those conclusions. However, in response to our request, for information underlying its conclusions, DCAA has addressed some of the previously cited deficiencies, including those relating to management fee and contingency costs in a letter, which we, as previously stated, will transmit separately.

DCAA is responsible for the attached report on NEON and the conclusions expressed in that report.

We thank you and your staff for the assistance extended to us during the audit. If you have any questions about this report, please contact Jannifer Jenkins at (703) 292-4996 or David Willems at (703) 292-4979.

Attachments:

DCAA Audit Report No. 3121-2014J11090001, *Independent Audit Report on National Ecological Observatory Network, Inc.'s Accounting System,* dated October 3, 2014

cc: Martha Rubenstein, BFA
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Elizabeth Blood, BIO
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